Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

# QUARTERLY JOURNAL

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# Office of the Comptroller of the Currency
# June 1990

Comptroller — Robert L. Clarke

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## Background

The Office of the Comptroller of the Currency (OCC) was established in 1863 as a bureau of the Department of the Treasury. The OCC is headed by the Comptroller who is appointed by the President, with the advice and consent of the Senate, for a 5-year term.

The OCC regulates national banks by its power to:

- Approve or deny applications for new charters, branches, capital or other changes in corporate or banking structure;
- Examine the banks;
- Take supervisory actions against banks which do not conform to laws and regulations or which otherwise engage in unsound banking practices, including removal of officers, negotiation of agreements to change existing banking practices, and issuance of cease and desist orders; and
- Issue rules and regulations concerning banking practices and governing bank lending and investment practices and corporate structure.

The OCC divides the United States into six geographical districts, with each headed by a Deputy Comptroller.

The OCC is funded through assessments on the assets of national banks.

## The Comptroller

Robert Logan Clarke became the 26th Comptroller of the Currency on December 10, 1985.

By statute, the Comptroller serves a concurrent term as a Director of the Federal Deposit Insurance Corporation and of the Resolution Trust Corporation, and as a member of the Federal Financial Institutions Examination Council.

An attorney, Mr. Clarke was formerly with the law firm of Bracewell & Patterson in Houston, Texas. He joined the firm in 1968 and founded its Banking Section in 1972.

Mr. Clarke received a B.A. degree from Rice University in 1963 and an LL.B. degree from Harvard University Law School in 1966. He served as a Captain in the United States Army from 1966 to 1968.

The Quarterly Journal is the journal of record for the most significant actions and policies of the Office of the Comptroller of the Currency. It is published four times a year in March, June, September and December. The Quarterly Journal includes policy statements, decisions on banking structure, selected speeches and congressional testimony, material released in the interpretive letter series, statistical data, and other information of interest to the administration of national banks. Suggestions, comments or questions about content may be sent to [illegible], Communications Division, Comptroller of the Currency, Washington, DC 20219. Subscriptions are available for [illegible] a year by writing to Publications—QJ, Comptroller of the Currency, [illegible].

# Quarterly Journal

# Office of the Comptroller of the Currency

Robert L. Clarke

Comptroller of the Currency

The Administrator of National Banks

# Contents

# The Condition of the Banking System in 1989*

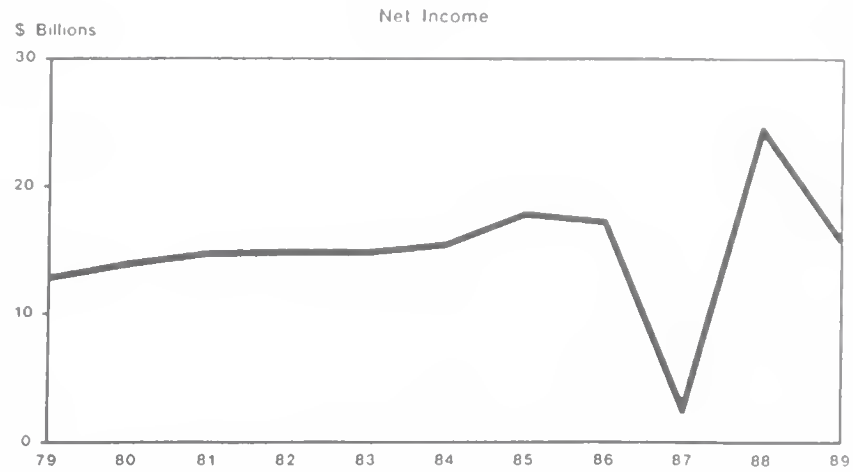
## Background

The 1980s were turbulent years for U.S. commercial banks. The number of bank failures rose steadily throughout the decade, and economic shocks — agricultural weaknesses early in the decade, the drop in oil prices in the mid-1980s, overbuilt real estate markets in the second half of the 1980s, and lingering weaknesses in many developing countries — contributed to volatile bank earnings and increases in problem loans.

In 1989, the turbulence persisted. Aggregate earnings dropped 33 percent compared to 1988, and 204 commercial banks failed, the highest level since the creation of the Federal Deposit Insurance Corporation (FDIC). Aggregate nonperforming real estate loans surged; in the Northeast, they more than doubled. Banks set aside more than $29 billion for future loan losses and charged off $22 billion in problem loans.

Despite these visible difficulties, many banks, especially smaller banks, prospered last year. More than half of the nation's banks registered higher profitability in 1989 than in 1988. Median return on assets (ROA), rose for the second consecutive year and, at 0.98 percent, reached its highest level since 1983.

Aggregate Bank Earnings Dropped
by one-third in 1989




Source: Call Reports

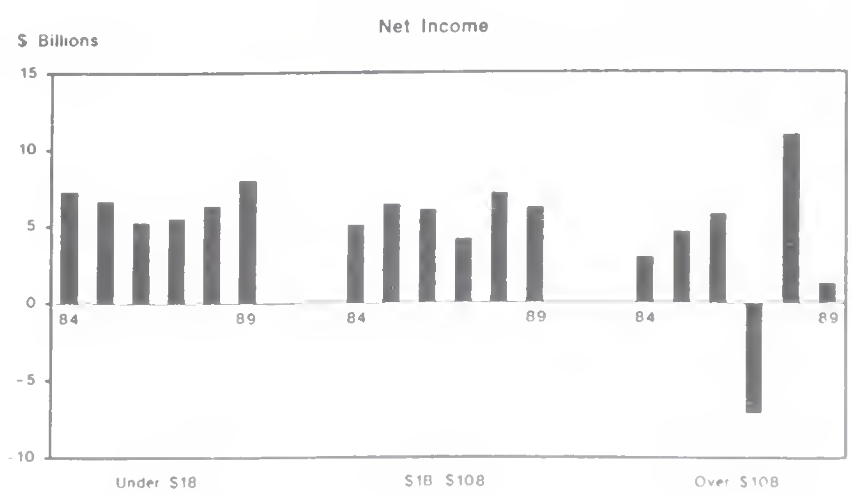
## Aggregate Bank Earnings Dropped in 1989

Largely because of problem loans, 1989 was a difficult year for many commercial banks in the United States. Aggregate net income dropped by nearly $9 billion (36 percent) to $15.6 billion last year. Earnings were pulled down by high and rising loan loss provisions, which increased $13.2 billion (82 percent) in 1989, to $29.3 billion. Mounting problems in real estate loan portfolios combined with continuing uncertainties surrounding loans to developing countries necessitated those loss provisions, especially during the second half of the year.

The 43 largest banks, with assets in excess of $10 billion, were the hardest hit in 1989. Their allocations to loss reserves rose by nearly $11 billion compared to 1988, contributing to a $9.6 billion drop in their reported earnings. Their profits plunged from $10.9 billion in 1988 to just $1.3 billion in 1989. In the OCC's Northeastern District, where many of those large banks operate, banks lost $300 million last year, after reporting profits of $11.6 billion the year before.

The weaknesses of the large banks masked improvement in the performance of smaller banks, especially the 12,163 banks with less than $1 billion in assets. These banks increased their aggregate income from $6.4 billion to $8.0 billion between 1988 and 1989, and their return on assets (ROA) rose from 0.70 percent to 0.86 percent.

**Plunge in Big Bank Earnings**
**Masks Improvement at Small Banks**




Source: Call Reports

*This article replaces the section "Operations of National Banks." Future issues will feature statistical data more current than previously reported.*

## Big Banks Augmented Primary and Equity Capital but More is Needed

Both primary and equity capital increased in 1989, primary capital rose $14.6 billion (6 percent), and equity capital increased $7.5 billion (4 percent). The ratio of primary capital to assets rose marginally from 7.90 percent to 7.92 percent, while the ratio of equity capital to assets dropped from 6.27 to 6.21 percent. At the biggest banks (assets above $10 billion), however, both primary-capital-to-assets and equity-capital-to-assets ratios dropped in 1989, reflecting loan charge offs and increased loan loss provisions.

Many of these big banks will have to augment their capital, especially equity capital, or reduce their assets, before risk-based capital requirements become operative in 1992. At the end of 1989, it is estimated that 620 banks failed to meet the minimum risk-based capital standards. Although representing less than 5 percent of all banks, these banks tend to be large banks which account for 44 percent of commercial bank assets.

## Real Estate Fueled Loan Growth, Despite Emerging Weaknesses

Real estate loans at the nation's commercial banks grew by $86 billion in 1989, accounting for 70 percent of total loan growth last year. This growth continued a five year trend, dating back to 1984, during which time real estate loans were responsible for 72 percent of the total rise in commercial bank loans. During that period, real estate loans nearly doubled — increasing from $383 billion to $750 billion — becoming the largest single category of bank loans.

Growth in real estate lending has not been without cost; nonperforming real estate loans and other real estate owned (OREO) have become increasingly prevalent at commercial banks. More than 4.6 percent of real estate assets were nonperforming as of December 31, 1989, compared to less than 3.6 percent five years earlier. In 1989 nonperforming real estate loans plus OREO increased $8.3 billion (31 percent), to $35.5 billion, fully accounting for the overall rise in nonperforming banking assets last year.

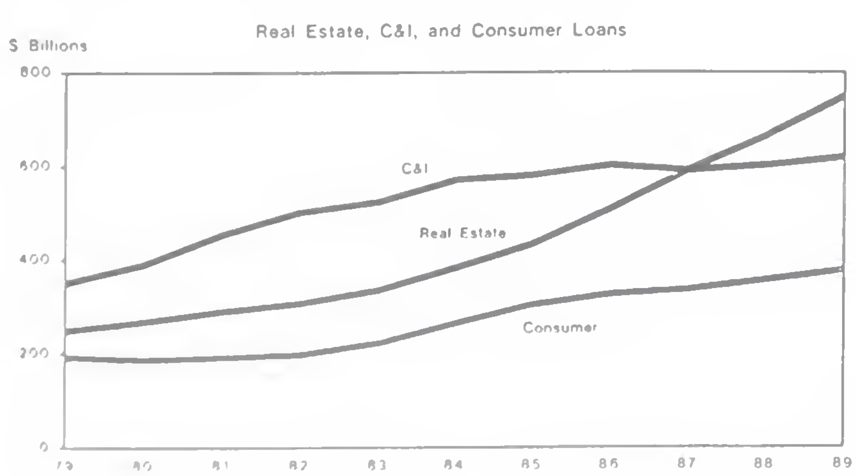
The increase in nonperforming real estate loans plus OREO was concentrated last year, as in earlier years, in banks with more than $1 billion in assets. In 1989, problem real estate assets rose $3.1 billion (37 percent) at banks with $1 - $10 billion in assets and jumped $5.7 billion (75 percent) at banks with over $10 billion in assets. In contrast, nonperforming real estate loans plus OREO dropped by $0.5 billion (4.2 percent) at banks with less than $1 billion in assets.

The banks most severely affected by problem real estate were located in the OCC's Northeastern District, reflecting weaknesses in real estate markets in the New England states. Nonperforming real estate loans plus OREO rose $7.0 billion (116 percent) in the Northeastern District; the next biggest regional increase was $0.8 billion (27 percent) in the Southeastern District.

## Exposure to Developing Countries Declined in 1989

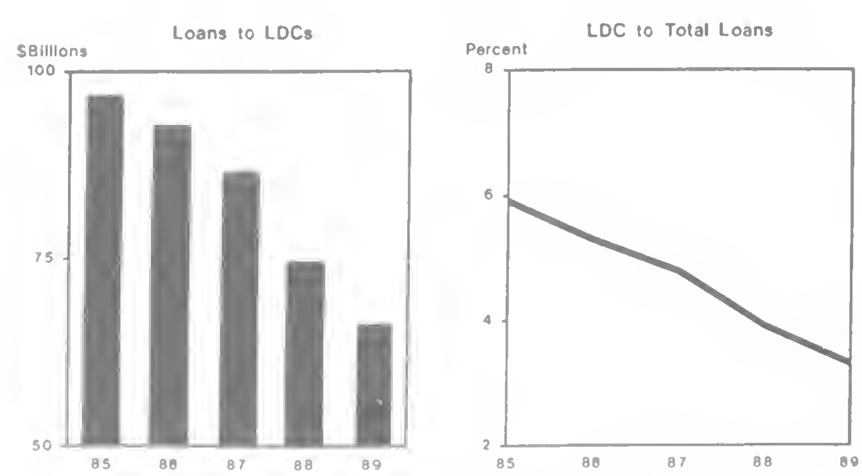
U.S. commercial banks continued to reduce their exposure to less developed countries (LDCs) in 1989. Their LDC loans dropped by $8.7 billion in the first nine months of the year (the most recent data available); they are now $30 billion below their level in 1985. As of September 31, 1989, LDC loans on the books of U.S. commercial banks amounted to $66.0 billion, or 3.3 percent of total U.S. bank loans. In 1985, LDC loans totaled $96.9 billion, or 5.9 percent of total U.S. bank loans.

**Real Estate Surges Past Other Loan Categories**




Source: Call Reports

**Lending to Developing Countries Declining**




Source: Country Exposure Report, Call Reports (Data as of September 1989)

## Bank Failures Were Concentrated in the Southwest

There were 204 bank failures in 1989, five more than in 1988. This was the eighth consecutive year in which the number of bank failures has risen. Failures were heavily concentrated in the Southwest; 166 banks (81 percent of the total failures) failed in the OCC's Southwestern District. Most failures were in Texas, where 133 banks (65 percent of the total failures) failed in 1989. Outside of the Southwestern District, bank failures fell for the second consecutive year in 1989 and have now dropped from 87 in 1987 to just 38 last year.

## Future Considerations

After reporting record earnings in 1988, the aggregate net income of commercial banks dropped by nearly $9 billion in 1989. Earnings were weakest among large banks, especially those in the Northeast, as these banks were saddled with problem LDC loans or loans to finance real estate land development and construction.

Looking ahead, foreign debt remains a concern, particularly for large banks. Although many smaller banks have rid themselves of all or most of their LDC debt, some of the large multinational banks will continue to face uncertainties surrounding their LDC loans.

Real estate is another concern. The real estate problems in the Northeast prominently affected bank performance there in 1989. Signs of overbuilding are also evident in other commercial and residential real estate markets. Thus problem real estate is likely to continue to adversely affect bank earnings in the future.

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Stephen W. Cross
Rose Ho
Industry and Financial Analysis Division

# The Bank Real Estate Price Sensitivity Model

## Introduction

Real estate lending has been a high growth activity for commercial banks for most of the past ten years, especially since 1984. In the last decade, real estate loans at the nation's commercial banks have tripled, growing from $248 billion to $750 billion; since 1984, real estate has accounted for 72 percent of the aggregate increase in bank loans. This rapid growth in real estate loans has been concentrated in banks with a billion dollars or more in assets; today, real estate loans represent the largest component of bank asset portfolios systemwide.

The rapid expansion in large bank real estate lending has not occurred without cost. Total real estate loan charge offs have nearly quadrupled in the last five years, from $880 million in 1984 to $3.4 billion in 1989, and, in that time, nonperforming real estate loans plus other real estate owned (OREO) have more than doubled, from $14 billion to $36 billion. Nonperforming real estate loans plus OREO rose by $9 billion in 1989 alone, an increase of 33 percent.

In light of the importance of real estate lending to national bank loan portfolios, as well as indications of weaknesses in some real estate markets — rising office vacancy rates, declining residential sales, and falling home prices in some communities — and the observed rise in problem real estate loans (past due, nonaccrual, and OREO) at national banks, the Office of the Comptroller of the Currency (OCC) has, in recent years, intensified its analysis of real estate markets and national banks' exposure to those markets. To facilitate the analysis, the OCC developed a computer program, or model, to simulate the effect of declining real estate markets on the value of banks' outstanding real estate loans and equity.

The computer program, called the bank real estate price sensitivity model, is typically applied to national banks located in or near communities with weak or weakening real estate markets. It helps identify national banks that may be vulnerable to real estate price declines. These banks become candidates for in-depth real estate examinations designed to determine the extent to which they are, in fact, vulnerable to a softened market. Thus the computer program helps the OCC to set supervisory priorities.

Some securities analysts, however, have written that the model does substantially more than that. For example, one report indicated that in using the model "the OCC predetermines the value of a bank's portfolio rather than looking at the value of the individual loans." Another report suggested that "the burden of proof [is] on the bank to demonstrate why a given credit should not be valued in line with the regulatory model." Other reports refer to the Comptroller's "black box," which is used by examiners to evaluate real estate loans. If any of these assertions were correct, concerns about the model would be warranted. None are.

## Key Features of the Bank Real Estate Price Sensitivity Model

Application of the price sensitivity model requires two steps: designate a series of assumptions that describe an environment in which a bank could operate in the future and instruct the model, or computer program, to carry out a series of calculations designed to estimate the impact of the assumed environment on banks' equity capital.

### Assumptions

Three assumptions about nonperforming real estate loans and OREO are critical to the assumptions about the environment within which banks operate:

- The range of values for individual banks' ratios of nonperforming loans and OREO to total real estate assets;
- Assignment of specific ratio values to individual banks; and
- The depreciation in the market value of nonperforming loans and OREO as carried on the books of banks.

The first critical assumption in the model specifies a range of values for ratios of nonperforming real estate and OREO to real estate assets. Experience demonstrates that not all banks will fare equally during periods of weak or declining real estate markets. As the aggregate ratio of nonperforming real estate loans in a given market rises, some banks will experience substantially higher rates of past due and nonaccrual loans while

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This paper was presented on May 3, 1990 to the American Bankers Association National Real Estate Conference. The author is the director of the OCC's Industry and Financial Analysis Division, the division responsible for the model described herein.

others will emerge relatively unscathed. Some banks will have little if any OREO while others may have OREO equal to 10 percent or more of real estate assets.

Once ranges of nonperforming loan and OREO ratio values have been specified, the second assumption is to assign specific ratio values within those ranges to individual banks. In most applications of the model, banks are assigned nonperforming loan ratios based on their management rating, which is one of five bank characteristics evaluated during examinations. Banks with a management rating of "5" are given values at the high end of the assumed range while those with a management rating of "1" are given values from the low end. Banks with ratings between "1" and "5" are given values between those two extremes.

Banks are also assigned ratios for OREO based on their current ratios of OREO to total real estate assets. We assume that banks that currently have relatively high percentages of their real estate exposure in the form of OREO are likely to have relatively high rates of OREO in the future, while those with relatively low rates are likely to have relatively low rates in the future.

The last of the three critical assumptions is the percentage depreciation in the market prices of different classes of real estate — land, commercial properties, residential properties. Percentage markdowns are based on a variety of forecasts about market conditions and current information obtained from liquidation databases maintained originally by the Federal Savings and Loan Insurance Corporation and currently maintained by the RTC and FDIC. Percentage depreciation must be specified for both nonperforming loans and for OREO.

### Activating the Model

Once these and other less important assumptions are identified, bank-specific call report information and examination data is entered into the computer program to calculate the dollar value of nonperforming real estate and OREO for each bank and the dollar depreciation in those assets obtained by marking them to market. The depreciation is subsequently subtracted from the bank's current equity capital to yield simulated equity capital levels. Banks with the lowest simulated equity capital ratios become likely candidates for a follow-up, targeted real estate examination.

The model has no other uses. In particular, it is never used to evaluate individual loans or, for that matter, in examinations at all. Moreover, not all candidates for examination suggested by the model are necessarily examined. The OCC uses a variety of information to set examination schedules; the price sensitivity model is but one of them. Traditional filters of bank financial ratios are also used as are the judgments of field examiners, district office staff, and senior OCC management in Washington.

## OCC Real Estate Examinations

A bank selected for a real estate examination will have some or all of the real estate projects in its loan portfolio analyzed. Detailed information about projects financed by those loans will be reviewed, such as information on outstanding leases, including lease terms and a listing of leases that are past due. Appraisals are also examined to assure that they are current and independent of the lending decision.

This project review, which also evaluates market conditions and collateral, is followed by an examiner's determination of a borrower's ability to meet current and future debt service requirements. This determination is critical to loan evaluation, not solely whether payments are presently past due.

In many instances, OCC examiners have found loans with significant weaknesses have remained on accrual status, either because there is sufficient interest carry in the unadvanced portion of the loan or because interest has been advanced under a separate but related loan made without additional collateral. In some cases, examiners have recommended that bank management place these loans on nonaccrual status with all payments being applied as reductions in principal until the borrower's ability to meet ongoing debt service requirements is demonstrated.

It would be a mistake to conclude that the bank real estate price sensitivity model underlies the examiners' decision to recommend that a loan be placed on nonaccrual status. It does not. Such recommendations are based on examiner evaluation of specific loans in the portfolio. Loans are recommended for nonaccrual status if there is a discrepancy between the outstanding loan balance and the examiner's judgment concerning the net present value of a project's estimated future cash flows.

The procedures used by examiners to calculate a project's net present value have long been in place, so it certainly is rasonable to ask why some bankers and bank analysts are convinced that the OCC is now using its model to "predetermine the value of a bank's portfolio." At least two factors appear to have contributed to the confusion about the model: the technology utilized and the model's name.

Confusion relating to the technology seems related to the fact that discounted cash flow calculations are sometimes made today using a laptop computer, making it easy to imagine that examiners are using a "black box" model to determine valuation, not something so mundane as a discounted cash flow calculation. Indeed, examiners sometimes refer to these calculations as the discounted cash flow "model." Some analysts and bankers have misinterpreted these references to a "model" by assuming that it is a "black box" that generates present value estimates or the assumptions used in their calculations, such as occupancy projections, estimates of net operating income, and the discount or capitalization rate.

That is not the case, however. There is no secret model determining valuation or the assumptions to be used in estimating valuation. The laptop computer merely requires less time for present value calculations; these calculations previously were made with a hand calculator, and before that, by the examiners with the best arithmetic skills.

The second basis for confusion appears to arise from the name of the model. When the bank real estate price sensitivity model was first introduced in December, it was referred to as the real estate valuation model; that name was changed because the word "valuation" may have implied that the model was being used to prescribe values for individual real estate credits. Coupled wth the increased use of computers by examination staff, some bankers and bank analysts may have concluded that examiners were using the so-called "valuation model" even though they were not. In fact, only about twenty people in the OCC are even trained to use the model — and, for the most part, they are analysts not examiners.

## Summary and Conclusions

The bank real estate price sensitivity model helps the OCC identify which of the nearly 4,200 national banks it regulates may warrant in-depth real estate examinations. Pursuant to certain assumptions, the program calculates the impact of a decline in real estate prices on a bank's nonperforming real estate loans and OREO and on its equity capital. Banks with significant differences between reported and simulated equity capital ratios become candidates for targeted real estate examination, though selection for such an examination is only made after consideration of other factors, including loan growth, equity capital, and known weaknesses with the real estate loan portfolio.

The computer program is not designed to be used, nor is it used, as a "black box" in examinations. It is a management tool used to assist in scheduling real estate examinations. It is not used by individual examiners in the field for loan reviews or to evaluate individual loans; they do that the old fashioned way. Principal among their techniques are discounted cash flow calculations used to estimate the economic value of individual real estate credits. Though computers are sometimes used to perform actual computations, these computational techniques have a long, if somewhat arcane, history.

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Stephen M. Cross
Industry and Financial Analysis Division

# An Assistance Program for the Recapitalization of Troubled National Banks

The Office of the Comptroller of the Currency (OCC) recently instituted an "assisting troubled banks" (ATB) program to help undercapitalized national banks locate outside sources of capital before they become insolvent. The program strives to help troubled national banks that continue to deteriorate despite bank efforts to reverse downward trends and the OCC's supervisory efforts. It is designed for banks that have determined that the best strategy to become viable and ultimately safe and sound is to seek outside capital. Administered by the OCC's Special Supervision Division in Washington, the ATB program also tries to reduce the number of failed national banks that expose the the Bank Insurance Fund to loss.

The program is voluntary for both investors and undercapitalized banks; it identifies potential purchasers and investors and puts them into contact with troubled banks. In addition to introducing the parties the OCC tries to reduce the "red tape" generally associated with recapitalization transactions so that the parties will be ready to consummate the transaction shortly after an agreement is reached.

Activities designed to expedite regulatory review time include the pre-screening of Change in Bank Control Act notices, acquisition proposals, and stock offerings soliciting capital. The program also provides advanced analysis of potential investors that submit financial and other background materials. Potential investors are asked to specify the geographic locations in which they are interested. The Special Supervision Division will evaluate the information and, if possible, "pre-approve" qualified prospective purchasers. In most cases, once a prospective purchaser is "pre-approved," the OCC only needs to evaluate whether a particular troubled institution can, given supervisory concerns, be acquired. The ATB's program administrators also provide expert opinions on the likelihood (or not) of a particular proposal making it successfully through the OCC's corporate application process.

The program is not designed to save banks on the verge of failure. Instead, it is aimed at assisting institutions while there is remaining value in the franchise. This is necessary if the bank is to be successfully marketed, unless other features such as location or market niche make it attractive to a particular investor. A troubled bank should consider entering the ATB program as early as possible because the chances of recapitalization diminish as an institution moves closer to insolvency. Investors are more likely to wait for banks near insolvency to fail and then attempt, through the failed bank bidding process, to purchase the bank out of a receivership.

In addition to reducing exposure of the Bank Insurance Fund, the program benefits the private sector. It expands recapitalization options available to problem banks but, significantly, it leaves the decision as to the fate of the bank in the hands of the board of directors and shareholders. Since the agency has found that most investors are interested in purchasing control of troubled banks, owners of a troubled bank should understand that a change in majority control will generally be involved. It also offers advantages to investors interested in entering or expanding into a desirable market because they may not experience as much competition as they would when bidding for failed banks.

Five troubled national banks, representing a potential savings to the Bank Insurance Fund of approximately $25 million, were recapitalized as a direct result of the program in 1989.

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Lance Cantor
Special Supervision Division

# Using Computers to Monitor National Banks

Dramatic changes in the "business of banking" have altered the nature of bank supervision during the last decade. No longer does the Office of the Comptroller of the Currency (OCC) operate on a calender-driven schedule of periodic examinations of national banks. Today, the OCC supervises every national bank on an ongoing basis. A key ingredient of the agency's ongoing monitoring of a bank's performance is the extensive use of computer-based data files containing comprehensive information on every national bank.

A recent addition to the OCC's computer system is a program which performs financial analyses of the approximately 3,800 national community banks with less than $1 billion in assets. The Supervisory Research Division in Washington spent two years developing this program, which is the agency's first microcomputer expert system. Known as "Bank ExpeRT," or BERT, the program identifies trends in a bank's performance and flags areas of potential concern. BERT has been fully operational for the past year.

BERT analyzes financial data in Uniform Bank Performance Reports (UBPR), analytical surveys based on Consolidated Reports of Condition and Income (call reports) submitted each quarter by all commercial banks. UBPRs include material on all areas of a bank's financial condition as well as peer group comparisons. UBPRs include a minimum of three years of bank and peer group financial data and are updated every quarter.

Prior to development of BERT, national bank examiners in the field reviewed UBPRs as part of their ongoing monitoring procedures. The analysis was time-consuming because it usually involved initial review by a junior examiner followed by a discussion of the findings with more experienced examiners. The agency wanted to streamline this review as well as ensure consistency in findings. It was also anxious to draw upon the knowledge of the agency's most experienced financial analysts and make their experiences available to other examiners.

BERT's developers conducted interviews with national bank examiners who were considered experts in analyzing financial data and making decisions about bank supervision based on that analysis. Together they possessed over 100 years of experience as examiners. all had a proven ability to isolate trends and identify potential problems from financial statements. The examiners also had experience identifying regional financial trends which the OCC believed would be useful to examiners located in other parts of the country.

After the examiners completed the review of several UBPRs, they were questitned about the financial elements they considered important, how they derived their conclusions, and how they would evaluate each particular situation. The identities and location of the banks were masked so that nonfinancial information could not be considered. The cases became increasingly complex, reflecting borderline situations which required the examiners to wrestle with their own decision making processes. These decisions, and the underlying reasons for them, were subsequently programmed into BERT.

Paralleling the financial information in UBPRs, BERT's analyses cover asset quality, allowance adequacy, earnings, liquidity, and capital. BERT operates unattended and can analyze up to 100 banks in a 12 hour period. The resulting reports are encrypted and password protected for security reasons. The report determines whether each area analyzed is a primary concern, a secondary concern, or of no apparent concern. If BERT indicates that a particular bank may possess a deficiency in one of these key areas, a change in the timing of the next supervisory activity for the bank might be warranted.

Following months of interviewing, coding, and re-interviewing, 17 examiners were asked to test BERT. They concurred with the expert system's findings on a particular bank's profile in 90 to 95 percent of the cases. After completion of the field tests, nationwide implementation began in May 1989. Training on the concepts behind expert systems and how BERT operates was then given to national bank examiners.

Some examiners use the report to identify areas they need to review. Others use it to verify information about a particular bank. Still others use it to analyze affiliate banks which they do not directly supervise. In all cases, BERT is used each quarter to keep examiners informed of potentially adverse trends in a bank's financial profile.

Although BERT is a key element of the analysis of community banks, it is only the beginning of the evaluation of a specific bank. The system is designed to augment examiners' knowledge about a specific bank and it does not supplant vital information such as the quality of the particular bank's management or the strengths and weaknesses of the local economy.

For the quarter ending March 31, 1990, BERT assisted in the analysis of over 90 percent of nationally chartered community banks. The system is currently being revised to improve the timeliness of the financial data.

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Wesley H. Zickefoose and Philip B. Osborn
Supervisory Research Division

# Recent Corporate Decisions

On January 11, 1990, the OCC approved an application filed by Sovran Bank, N.A., Richmond, Virginia for an operating subsidiary to engage in the creation and issuance of mortgage-backed securities to be sold either through public offerings or private placements.

On January 19, 1990, the OCC granted Florida Street National Bank, Baton Rouge, Louisiana preliminary approval of a liquidating national bank charter. This was the OCC's second approval to form a liquidating bank without Federal Deposit Insurance Corporation (FDIC) assistance. The liquidating bank will acquire and collect problem assets of an affiliated bank.

On January 22, 1990, the OCC approved an application filed by First National Bank of Ames, Ames, Iowa to establish five CBCT branches. The approvals were based upon documented evidence that the bank had taken significant steps to improve its Community Reinvestment Act (CRA) performance.

On January 31, 1990, the OCC disapproved an application to charter a national bank. The disapproval was based on the organizers' weak operating plan, the low initial capitalization, and the experience level of proposed management, given the market in which the proposed bank would be operating.

On November 6, 1987, the OCC granted preliminary approval for a federally chartered thrift to convert to a national bank to be called First City National Bank, Memphis, Tennessee. The federally chartered thrift first converted to a state-chartered thrift, then to a state bank, and finally to a national bank. On February 1, 1990, the proposal was consummated after the applicants received all required regulatory approvals from the Office of Thrift Supervision (OTS), state regulators, and the FDIC.

On February 26, 1990, the OCC approved two corporate reorganization merger applications involving Wells Fargo Bank, National Association, San Francisco, California. Both applications were protested on CRA grounds. After considering the protests and assessing the bank's CRA performance, the OCC unconditionally approved the applications because it determined that Wells Fargo was meeting the credit needs of its entire community in a satisfactory manner

In March 1990, the OCC denied a change in bank control notice in which the president and two other individuals would have acquired 100 percent of the bank's stock. The OCC denied the notice because the applicants lacked the financial capacity to acquire this troubled bank. The inadequate plan for financing the stock purchases and the poor condition of the bank also called into question the applicants' ability to provide the managerial expertise needed.

On March 20, 1990, the OCC conditionally approved a proposal to expand the activities of an existing subsidiary to include the sale, as agent, of an annuity product that combined elements of both fixed and variable rate annuities. The decision relied on two previous and separate determinations by the OCC that fixed and variable annuities are permissible activities for national banks. To address supervisory concerns, outlined in previous OCC interpretive letters, the OCC required the subsidiary to expressly disclose in its advertising, promotional materials, and discussions with customers that the annuities are not products of the subsidiary and are not FDIC insured. Furthermore, the OCC required the subsidiary to obtain from the customer, before a sale is made, a signed statement that the customer understands that the annuity is an obligation of the issuing insurance company, that the subsidiary is acting only as agent for the insurance company, and that the annuity is not FDIC insured. Finally, the OCC required the subsidiary to determine whether any state laws govern this type of activity, and to the extent that they do, to comply with them.

On March 20, 1990, the OCC approved the expansion of an investment advisory and brokerage activities subsidiary to include the offering of a fixed rate annuity product as agent. The OCC imposed the same conditions as those contained in the operating subsidiary notice summarized above.

During the first quarter of 1990, the OCC also denied a charter application because of weaknesses in the bank's operating plan, especially funding weaknesses, inadequate banking experience of the organizers, and the OCC's concern about the lack of candor and forthrightness of key organizers

*This section contains summaries of selected corporate decisions completed during the first quarter of 1990 The cases are provided for informational purposes only They are noteworthy because they represent issues of importance or unusual methods of accomplishing a particular expansion activity Copies of the public sections of the applications may be obtained from the Communications Division of the Office of the Comptroller of the Currency (OCC) in Washington, D C.*

On March 26, 1990, the OCC approved a series of applications which enabled Wells Fargo Bank, N.A., San Francisco, California to enter into a general partnership with Nikko Securities Co., Ltd. On the same date, the OCC approved the general partnership's application to own a new national trust company. Wells Fargo entered into the transaction as an opportunity to generate significant trust and investment management business in another country. The conditions imposed by the OCC were designed to prevent extraordinary resource demands on the bank and to insure continued capitalization of the new trust company.

## Corporate Decisions Related to the Community Reinvestment Act*

On January 8, 1990, the OCC conditionally approved two CBCT branch applications submitted by The First National Bank of Toms River, Toms River, New Jersey. In reviewing this branch proposal, the OCC determined that the applicant's CRA performance was less than satisfactory in identifying community credit needs within its delineated community, in assessing its marketing efforts within all parts of its community, and in reviewing the geographic distribution of credit extensions. To help assure compliance with CRA, the OCC conditioned its approvals upon submission of a plan of action to the OCC. The action plan was being developed by the bank to address CRA deficiencies identified in a recent examination. The OCC also required the applicant to submit a self-assessment of its performance under CRA and its plans to correct any identified deficiencies. The OCC required both conditions to be met before either CBCT branch could open for business.

*This section is provided pursuant to Banking Circular 238, dated June 15, 1989. It includes summaries to provide easier access to OCC decisions relating to national bank corporate applications that have been conditionally approved or denied on grounds related to CRA. The actual decision letters are published monthly in a document entitled Interpretations, which is available upon request from the Communications Division.*

On February 12, 1990, the OCC conditionally approved a branch application submitted by Mercantile National Bank of Indiana, Hammond, Indiana. During its review of the application, the OCC determined that the applicant's CRA performance was less than satisfactory in determining community credit needs and in evaluating the geographic distribution of the bank's credits. However, in response to its most recent compliance examination, the applicant had developed a CRA action plan to overcome deficiencies which also included time frames for corrective action. The approval precluded establishment of the branch until the action plan has returned the bank's CRA performance to a satisfactory level.

On March 19, 1990, the OCC conditionally approved two CBCT applications submitted by Sunwest Bank of Albuquerque, National Association, Albuquerque, New Mexico. The applicant's performance was considered to be less than satisfactory in determining community credit needs and in monitoring and analyzing the geographic distribution of credit provided by the bank. Although the bank had developed an action plan to correct deficiencies, additions to the plan were required. In addition, the OCC delayed approval of establishment of the CBCT's until improved performance under the plan is demonstrated.

On March 29, 1990, the OCC conditionally approved three branch applications submitted by First Interstate Bank of Texas, Houston, Texas. During an examination, the OCC determined that the bank had made less than satisfactory efforts to determine community credit needs and marketing, to monitor and analyze the geographic distribution of credit within its delineated community, and to develop policies to monitor credit practices. Approval of the branch applications was conditioned upon the bank correcting the deficiencies noted in the Report of Supervisory Activities. While an action plan for correction had been prepared by the applicant, demonstrated performance under the plan was required prior to opening the branches.

# Change in Bank Control Act

The Change in Bank Control Act of 1978 (CBCA) requires parties seeking control of a bank or bank holding company to obtain approval from the appropriate federal banking agency before the transaction occurs. Under the act, the OCC is responsible for reviewing changes in the control of national banks including the financial capacity, competence, experience, and integrity of the acquiring party; the effect on the financial condition of the bank to be acquired; and the effect on competition in any relevant market. Pursuant to the Financial Reform, Recovery and Enforcement Act of 1989, the OCC must also consider the effect of the transaction on the Bank Insurance Fund.

Public notice of each proposed change in control is published in the newspaper of largest general circulation in the community where the national bank's home office is located. In addition, the OCC assesses the qualifications of each party seeking control, and routinely investigates and verifies information contained in each change in control notice.

The OCC acted on 55 proposed changes in control of national banks in 1989. It consented to 48 proposals, disapproved 3 and 4 were withdrawn prior to decision. Consistent with the OCC's experience in previous years, disapprovals resulted from the unsatisfactory financial capacity, experience, integrity, or competence of the acquiring party.

Total CBCA notices processed, with disposition, 1985-1989

| *Year* | *Acted On* | *Not Disapproved* | *Disapproved* | *Withdrawn* |
|---|---|---|---|---|
| 1989 | 55 | 48 | 3 | 4 |
| 1988 | 42 | 34 | 4 | 4 |
| 1987 | 60 | 41 | 8 | 11 |
| 1986 | 71 | 54 | 4 | 13 |
| 1985 | 102 | 74 | 12 | 16 |

# Speeches and Congressional Testimony

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## Of the Comptroller of the Currency:



## Of senior officials of the Comptroller of the Currency:

# Remarks by Robert L. Clarke before the Institute of International Bankers, on trends in the U.S. banking system in the 1990s, New York, New York, January 8, 1990

The day after Henry Kissinger was nominated as U S. Secretary of State in 1973, he held a news conference. At the close of the conference, a reporter asked· "Do you prefer being called Mr. Secretary' or Dr. Secretary'?" "I don't stand on protocol," Kissinger replied, "just call me . . . Your Excellency.'"

Names, titles, and labels are dangerous things because if we're not careful, we begin to think in labels, rather than in terms of the realities the labels represent.

Consider, for example, the label "bank." Here in the United States, it defines institutions that, on one hand, are chartered and supervised under a legal definition of "bank" by some governmental authority and that, on the other hand, perform a business function called "banking." But the label is misleading. Any number of institutions can — and do — perform the business function called "banking."

Why, then, have a charter?

For the banker, the chief, and perhaps the sole, virtue of holding a bank charter today is that a bank can accept federally insured deposits, and, consequently, it is perceived by the members of the public as a safe place to put their money. A decade or so ago, the label "bank" in the United States would have described much more: a unique institution; an institution the government protected against competition, in part by restricting entry of competitors into its territory and by granting it exclusive authority to issue checking accounts; an institution whose products were priced by government fiat; an institution practically guaranteed against failure. Then came the 1980s — and the world of U.S. banking turned upside down.

Now comes the 1990s — a decade in which, I believe, we will see changes even greater than those that occurred in the 1980s. Today I would like to discuss with you a few of the changes I see coming. And all the time I'm talking I want you to keep in mind that the label "bank" should describe a changing reality. That is to say, the picture in our minds should conform to reality. We should not try to force reality into conforming to the pictures in our minds.

That's an important point because by the year 2000, the banking system in the U.S. promises to be very different from what we call the banking system today.

Three broad trends, I believe, will shape changes to the banking system in the U.S. in the next few years — three trends that will erode and crumble all our old assumptions involving banks consolidation line-of-business expansion, and changes in ownership

First, consolidation. Since 1980, the United States has witnessed a significant consolidation of banking organizations In 1980, we had about 14,400 banks in the U.S. Today, we have about 12,600. In 1980, we had 12,358 banking organizations — independent banks and bank holding companies — in the United States. By 1988, the number had declined to 9,830

As the number of commercial banks and separately owned banking organizations declined, the number of holding companies operating in more than one state increased, and banking assets have become more heavily concentrated in the largest banks and holding companies.

Additional consolidation is likely as more and more states permit both statewide branching and the ownership of banks by holding companies headquartered outside their boundaries. Consequently, I expect a substantial decrease in the number of banks. I also expect to see a substantial rise in the number of multistate bank holding companies.

Our economists at the OCC recently forecast how they believed the consolidation trend would continue through the end of 1992. They concluded that the total number of banks would fall to below 11,000 by the end of 1992, a decrease of about 2,000 banks from where we are today.

This forecast does not take into account those thrift institutions that convert, or are converted. to a bank charter under the Financial Institutions Reform, Recovery and Enforcement Act. Nor does it take into account changes in federal law governing bank branching across state lines. But even when you take those exceptions into account, it's easy to see where the trend is headed even if the exact projections are not met There will be fewer, but larger, U.S banking organizations by the end of 1992, and an increasing number of them will own banks in more than one state.

Some people in the United States still believe that further major consolidation will not occur Believing that major consolidation won't continue to occur, however won't prevent it from doing so The signs and the economic realities, are there for anyone to read

The second trend that will reshape banking in the U S in the 1990s is continued expansion of the menu of

services that banking organizations can offer. Thanks to regulatory judgments, banks and bank holding companies have significantly greater powers in the securities business than they had just last year. The Glass-Steagall Act, which has separated commercial from investment banking in the U.S. since its passage in 1933, nearly 60 years ago, is not dead — it is simply not as great an obstacle as it used to be.

Given the strong support in some sectors of the life insurance business for allowing commercial banks to enter that business, I also expect the barriers that block banks from acting as agents in insurance will fall sometime within the decade and will be followed by the fall of other barriers to other businesses.

The third trend that will reshape banking in the U.S. in the 1990s is a likely change in the ownership of U.S. banks. As you all know, there is a long-standing division between banking and commerce in U.S. legal and regulatory thought. In recent years, critics have debated whether that division has a historical basis, arguing that until the turn of the century, banks in many states in the U.S. could engage in what today would fall under "commerce." Advocates of maintaining the division have argued that banks in many states were prohibited early on from engaging in what today we would call "commerce."

Even if there is a historical basis for the division, the question being asked more and more today is: "Does it make sense now? Why deny the ownership of a bank to an industrial firm, a retailer, or another type of service firm, if concerns about conflict of interest and self-dealing can be met? Given the facts that many firms that would fall under the rubric "commerce" can provide a healthy source of capital for banks — and that capital for banks is sorely needed — it is a question worth asking.

In the coming years, you'll hear it asked more and more, but the answers you will hear, I predict, will be different from those you've heard before.

In the coming years, too, we are likely to see an increase in the number of U.S. banks owned by non-U.S. companies, a trend which goes part-and-parcel with growing overseas investment in the U.S. And, with the development of a global economy, we'll probably see more U.S. involvement with overseas banking, too — or at least I hope we will.

Consolidation [illegible] line-of-business expansion [illegible] ownership.

Because of these trends, the word "bank" will have a far different meaning 10 years from today than it does now.

And, to be perfectly frank with you, bank supervision will have a far different meaning 10 years from today than it does now.

In anticipation of the future, we have developed at the OCC a different approach to supervision, a method of supervision for the future that emphasizes ongoing oversight and financial analysis.

In doing so, we aim to find problems while they are incipient and to react to them more quickly. The largest national banks in the U.S. have one of our senior OCC examiners on duty at the bank full-time, not because the bank is considered in trouble, but because its operations are so complex and geographically dispersed that supervision is a full time job.

As for other national banks, each bank is assigned an examiner who monitors that institution. If it is a major regional bank, a senior examiner may be assigned only to that one bank. Other examiners have a portfolio of smaller banks for which they are responsible.

The examiner in charge regularly gathers and analyzes extensive information on each bank for which he or she is responsible. The information gathered and the analyses performed are designed to address the level of risk in each bank. This information is placed in a computer-based data file, which is updated frequently and is available to our supervisory staff and to our fellow federal bank supervisors at all times.

Furthermore, because banks can be affected so significantly by changes in the environment in which they operate, the OCC's supervision also includes the development of information about emerging trends in economic conditions. Analyses performed regularly by our economics staff in Washington and environmental analysts in each of our six district offices help define the depth and scope of regional and national systemic risks. When such risks are identified, the OCC can direct attention to specific activities in particular groups of banks known to be vulnerable to these risks, sometimes before problems occur. For example, because of our concerns about the softening commercial and residential real estate markets in some cities, in 1988 we conducted examinations focused on the real estate lending practices of national banks with large real estate loan exposures. We held group meetings with managers and directors of a large number of banks in the regions involved to sound an "early warning" about the things we were observing. We also met with managers and directors of the individual banks where our findings raised supervisory concerns.

Where are our next concerns? Without focusing on any geographic area, I can tell you that we are concerned

about a significant rise in nonperforming consumer loans at banks around the country. Third quarter data on national bank exposure indicated a significant increase in this area. Is it a geographic risk — or even a systemic risk?

We're not sure yet. We are now analyzing the data and trying to determine precisely what this implies for the overall condition of the national banking system. In other words, we are evaluating just how serious our concern should be. And we hope the banks that are significantly exposed in this area are doing the same type of analysis and evaluation to determine what the rise in nonperforming consumer loans means to them, too.

Clearly, we have come a long way from just going into a bank once every year or two and checking its loan file. But just as clearly, as the decade of the 1990s opens, I believe we will have a long way to go to keep our supervision of banks equal to the task.

For example, each of the three trends I have discussed brings with it supervisory concerns: in consolidation — as banking organizations operate across state boundaries, as banking organizations become nationally oriented, so, too, must our supervisory efforts. And as more banks are converted to branches, we must pay increased attention to reviewing the information systems in banking organizations; in expansion in lines-of-business — building expertise among our supervisory personnel will be, to say the least, a challenge; and, finally, in ownership, where we don't have the access to information about foreign owners that we have with domestic owners.

Beyond these specific supervisory concerns is a greater, more general, one: Is our structure of regulatory institutions effective and efficient given their mission? Should we reconstruct the regulatory scheme to better reflect reality?

I'm sure many of you have already heard the talk of combining the OCC with the Office of Thrift Supervision. While that talk has gone nowhere yet, it points out that the old assumptions are being questioned. And I expect them to continue to be questioned.

I expect questions such as "Why do we need four federal agencies to perform bank supervision?" "What is the proper role of the Federal Reserve System — the central bank — in bank supervision?" "What is the proper role of the FDIC — the deposit insurer — in bank supervision?" And: "What is the proper role of the primary charterer and primary supervisor of national banks, the OCC?"

We need to ask these questions. We need to ask other questions and to look at all the alternatives. If we deprive ourselves of information by not asking the right questions, we will have to live with the results, even if we don't like them.

A large employer in the small town where I grew up learned that lesson. He was known for his curt, dictatorial manner. His style of management was to give orders and expect workers to follow them. He asked one new employee about his previous employment. "I worked in a barbershop," came the answer. "Okay, give me a haircut," commanded the employer, calling for his secretary to bring scissors and comb. The new worker was stunned but administered the haircut.

When the employer saw the results, he was infuriated: "You call this a haircut?" he stormed. "My gardener could do better!" "He probably could," agreed the new employee. "My last job was shining shoes."

In short, in the 1990s I see the U.S. to be a land of opportunity for good investments and for good business. Because it will be the land of opportunity — and because the economy needs it — I hope that by the end of the decade, and preferably much sooner, we will have a modernized banking system capable of assuming its appropriate role in the global marketplace.

For some people, the changes to come will be beneficial. To others, they seem to pose a threat. But they are coming, they cannot be denied, and they will transform the system. Whether they are a threat or an opportunity will depend on how well we — and the U.S. banking system — prepare for them.

# Remarks by Robert L. Clarke before the New York State Bankers Association, on contraction of the U.S. bank presence overseas, New York, New York, January 25, 1990

For the next few minutes, I want to discuss with you the general forces that will, I believe, shape banking over the next few years — my forecast, if you will. But before I do, I want to recall the wisdom of Solomon (economist Ezra Solomon) who said several years ago that "the only function of economic forecasting is to make astrology look respectable."

Several broad trends, I believe, will shape changes to the banking system in the U.S. in the next few years. At least three seem clear: consolidation; line-of-business expansion; and changes in ownership. In addition, another trend of major significance is becoming apparent: a shrinking of the U.S. bank presence in foreign markets.

As a matter of policy, this retreat concerns us. It concerns many interested observers, both inside the industry and outside it. And it concerns the U.S. Congress. It is clear that, for the U.S. to be a significant player in the global economy now emerging, it is necessary for U.S. banks to be significant players, too.

Let's look at each trend briefly, beginning with consolidation. Since 1980, the United States has witnessed a significant consolidation of banking organizations. In 1980, we had about 14,400 banks in the U.S.; today, we have about 12,600. In 1980, we had 12,358 banking organizations — independent banks and bank holding companies — in the United States. By 1988, the number had declined to 9,830.

As the number of commercial banks and separately owned banking organizations declined, the number of holding companies operating in more than one state increased, and banking assets have become more heavily concentrated in the largest banks and holding companies.

Additional consolidation is likely as more and more states permit both statewide branching and the ownership of banks by holding companies headquartered outside their boundaries. Consequently, I expect a substantial decrease in the number of banks. And I expect to see a substantial rise in the number of multistate bank holding companies.

Our economists at the OCC recently forecast how they believed the consolidation trend would continue through the end of 1992. They concluded that the total number of banks would fall to below 11,000 by the end of 1992 — a decrease of about 2,000 banks from where we are today.

This forecast does not take into account thrift institutions that convert, or are converted, to a bank charter under the Financial Institutions Reform, Recovery and Enforcement Act. Nor does it take into account changes in federal law governing bank branching across state lines. But even when you take those exceptions into account, it's easy to see where the trend is headed even if the exact projections are not met: There will be fewer, but larger, U.S. banking organizations by the end of 1992, and an increasing number of them will own banks in more than one state.

The second trend that will reshape banking in the U.S. in the 1990s is continued expansion of the menu of services that banking organizations can offer. Thanks to regulatory judgments, banks and bank holding companies have significantly greater powers in the securities business than they had just last year. The Glass-Steagall Act, which has separated commercial from investment banking in the U.S. since its passage in 1933, nearly 60 years ago, is not dead — it is simply not as great an obstacle as it used to be.

Given the strong support in some sectors of the life insurance business for allowing commercial banks to enter the business, I also expect the barriers that block banks from acting as agents in insurance will fall sometime within the decade, and will be followed by the fall of other barriers to other businesses.

The third trend that will reshape banking in the U.S. in the 1990s is a likely change in the ownership of U.S. banks. As you all know, there is a long-standing division between banking and commerce in U.S. legal and regulatory thought. In recent years, critics have debated whether that division has a historical basis, arguing that until the turn of the century, banks in many states in the U.S. could engage in what today would fall under "commerce." Advocates of maintaining the division have argued that banks in many states were prohibited early on from engaging in what today we would call "commerce." Even if there is a historical basis for the division, the question being asked more and more today is: "Does it make sense now?" Why deny the ownership of a bank to an industrial firm — or a retailer — or another type of service firm — if concerns about conflict of interest and self-dealing can be met? Given the facts that many firms that would fall under the rubric "commerce" can provide a healthy source of capital for banks, and that capital for banks is sorely needed, it is a question worth asking.

In the coming years, you'll hear it asked more and more, but the answers you will hear, I predict, will be

different from those you've heard before. In the coming years, too, we are likely to see an increase in the number of U.S. banks owned by non-U.S. companies, a trend which goes part-and-parcel with growing overseas investment in the U.S.

Consolidation . . . line-of-business expansion . . . ownership . . . these trends are clear.

Just as it seems reasonably clear that the dollar volume of overseas activities of U.S. banks has declined substantially during the past six years or so, a pull back more or less across the board. While the retreats in foreign retail and securities markets have received the most attention recently, they probably account for a relatively small fraction of the total decline in the overseas business of U.S. banks, most of which has been in wholesale banking activities.

Many factors have contributed to the decline. I've been told by a number of your colleagues that, as a reaction to the developing country loan problems of the last decade, securities analysts and outside bank directors turn a cold eye toward any lending activities of an international nature. The desire to avoid additional LDC losses is understandable, but if a bank reacts indiscriminately by avoiding all foreign credits, it will risk losing valuable customer relationships to competing banking powers that may be difficult to recapture.

Furthermore, I've been told that, while consolidation is taking place in the U.S., it is more difficult because of the restrictive U.S. banking structure, and that, consequently, our largest banks find it difficult to attain the critical mass necessary to maintain a significant presence overseas.

In addition, U.S. banks must pay more for capital than many foreign competitors. And while U.S. banks face growing and tougher competition from a growing number of emerging financial centers — not just Japan, but centers throughout Asia and elsewhere — the cost of capital for U.S. banks makes the financial consequences of such competition even tougher.

The increased competition directly affects U.S. market share and also shrinks profit margins, thus making it less attractive for U.S. banks to invest in foreign markets. We must take into account, though, that this increased competition may be the natural outgrowth of the imbalance in our nation's trade balance, which stems from factors outside the banking system. One consequence has been that foreign ownership of U.S. assets has increased. It would not be surprising to see some transfer of ownership of bank assets occurring naturally as part of that trend.

I believe there is one more factor that accounts for U.S. banking's retreat in foreign markets: U.S. banks may be pulling back because their resources are needed to deal with domestic concerns and problems, such as capital requirements, weakened borrowers, and heavy competition from other financial service providers. Additionally, U.S. banks are husbanding their resources to develop strategies for coping with changes in our domestic banking structure.

We must face the fact that, with few exceptions, U.S. banks are not competing, or have elected not to compete, fully in foreign fields. In the emerging global economy I believe there are only two types of markets: world-class and second-class.

While — as a government official — I cannot question the reasoning of any particular institution to forgo foreign financing, as a government official I can express concern when our banking system as a whole withdraws from world-class markets.

I've talked about trends today that will shape banking tomorrow: consolidation, expansion of services, ownership changes, presence abroad. It seems to me that for U.S. banks to be successful in the face of these changes, they must be strong. And to be strong, they must prepare now. They must prepare by focusing on operating fundamentals. They must prepare by building capital. Only by being strong will U.S. banks be able to weather difficulties domestically and internationally in the years to come. But just as important, only by being strong will U.S. banks be able to take advantage of whatever beneficial changes might come their way. And only by being strong can U.S. banks take up their role as major players on the world stage.

# Remarks by Robert L. Clarke before the National Council of Savings Institutions, on real estate lending, Washington, D.C., February 28, 1990

Back during the Second World War, a Royal Air Force pilot was shot down over Germany and wound up in a German hospital. The doctor fixed the British flyer up but told him he would have to amputate his right leg to save his life.

After the flyer recovered from the shock of the bad news, he asked the doctor if he would do him one favor. The doctor, being a compassionate man, said that he would try. The flyer said: "Would you give the leg to one of your friends in the Luftwaffe on the next run and have him drop it over England with the note: In service of my king'?"

The doctor agreed and it was done.

A week later the doctor came in with the sad news that the other leg would have to be amputated also. The flyer naturally was upset, but requested that the doctor please have one of the German flyers drop it over England with the label: "In service of my king."

The doctor agreed and it was done.

A month later the doctor came in again and told the flyer he was sorry, but to save his life he would have to amputate his right hand. The patriotic English flyer started to make his usual request, but the doctor interrupted him and said: "I'm very sorry but I can no longer grant your request."

The pilot asked: "Why not?" And the doctor replied: "The S.S. thinks you're trying to escape."

People crave explanation. And when they don't receive one, they'll make up one on their own. Consider this rumor. In the period of uncertainty following the crisis at Continental Illinois Bank in the early 1980s, a rumor swept the financial markets that the roof was about to cave in at one of the country's largest banks. There was a seed of truth to the rumor.

The roof of the building where this financial institution had its headquarters had, indeed, been weakened by the weather — a fact known to many of its employees. One can imagine one of these employees talking to a friend on the telephone and saying: "Did I tell you? My boss says the roof is about to cave in on this place."

But that doesn't account for the wide acceptance of the rumor in the market. In fact, this bank's stock had suffered a severe decline in the days before the rumor, and the rumor would account for the decline. Thus the stock decline made the rumor reasonable.

Rumors don't have to be malicious to be believed. They only have to be credible.

In his recent book *Wartime: Understanding and Behavior in the Second World War*, the noted scholar and critic Paul Fussell points out that rumors in wartime give meaning to experience: They explain to soldiers in the field why what is happening to them is happening. In this respect, he explains, bad news is better psychologically than no news at all; having no reason is more disorienting than having the wrong reason.

People fill in the narrative gaps in their experience, a process that psychologists call: "closure."

While all this is interesting, I'm sure many of you are silently asking yourselves: "What does it have to do with finance, and particularly, what does it have to do with the members of this organization: thrift institutions?" In one specific way, the answer is: "Quite a lot."

As you all know, Congress explicitly and implicitly intended to make the supervision of national banks the standard for the future supervision of savings and loan institutions when it considered and passed the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA).

For example, in the future savings and loans will have to meet capital standards at least as stringent as those imposed on national banks. I'm sure that every thrift executive in America knows by now what national bank capital standards are, and what they mean for his or her institution. But, having had little reason to delve into the subject earlier, thrift executives have little grasp of the rest of national bank supervision, and particularly of the philosophy and conceptual foundations on which the OCC has built the national bank supervisory process over the years. Rumors and misinformation abound concerning what we at the OCC do and how and why we do it.

Because effective supervision for all depository institutions is the order of the day in the post-FIRREA world, I want to spend a few minutes walking you through our approach to supervision to give you a better idea of how we do it. With this explanation, I hope to lay the rumors to rest and to entomb the misinformation beside them.

The OCC has one and only one policy goal: Assuring the safety and soundness of the banking system. We have no insurance fund to manage, as does the Federal Deposit Insurance Corporation. We have no monetary policy to conduct, as does the Federal Reserve Board. More to the point for the message I want to deliver today is the fact that we in no way prejudge a banking market or a business activity as inappropriate — on its face — for banking.

I, and my predecessors over the last 25 years, have been strong advocates for expanding the range of activities banks can conduct, which viewed in another way, is to say the range of services banks can offer. Such expansion would give customers more opportunities to purchase financial products conveniently and, furthermore, our economy would benefit from U.S. institutions being more competitive with institutions abroad and stronger from having their risks diversified and capital bases widened.

However, at the OCC we must also face the fact that some bankers make terrible managers. That's not surprising when you consider our system has 12,600 banks.

The first day I was at Harvard Law School, the dean told all of us assembled that we were there because we were in the top of our college classes, but we had to realize that 10 percent of us would be the bottom 10 percent of our class at Harvard Law School. In any group, 10 percent of the group is the bottom 10 percent. Banking has a bottom 10 percent, too.

Some bankers make mistakes because they are sloppy; they won't take the time and make the effort to establish information and control systems that will allow them to function properly as managers. Whatever you cannot measure, you cannot manage. Some bankers make mistakes because they are inept. They mismeasure the risks they assume and, thus, inevitably mismanage them. And some bankers — fortunately, relatively few — make mistakes because they are corrupt. I don't have to tell you that finding and eliminating the dishonest banker is a part of our mission that we take especially to heart.

But our philosophy at the OCC is not to manage, much less micromanage, the institutions under our supervision. That's what bankers are for.

Rather, our philosophy is to assure that the institutions under our supervision have good management: Managers with the intelligence, the experience, and the systems to measure risks and keep them under control. But, in order to avoid putting us in a position where we need to involve ourselves in the management of banks, bankers have to take responsibility for establishing and maintaining good risk identification and management policies and systems in their institutions.

In short, the safe and sound bank is the well-managed bank, and well-managed is defined by whether a manager has created a structure which includes systems and policies within his institution appropriate to that singular institution's need.

We want our supervision to have the feel — in the words of the popular Broadway song — of a "singular sensation." We want, as far as technically and technologically possible, to custom-cut our supervision to the profile of each individual bank we supervise. Each institution we supervise is subject to ongoing monitoring and each institution we supervise is subject to our examination.

Our policy goal, our objective, is nothing less and nothing more than to put our supervisory philosophy — that the well-managed bank is the safe and sound bank — to work in the real world every day. And to put it to work at every bank individually.

One of our former chief counsels described our approach to supervision in another way. He said: "We're out to change people's behavior." That is also a valid way of describing what we are about.

There can be a limitless number of ways you can control people's behavior, but they all boil down to one of three approaches. You can make someone do something. You can forbid someone from doing something. Or you can create the conditions where someone will want to do something — or will want to avoid doing something — on their own and of their own free will because it makes sense. The first two ways use force. The third way relies on reason. We favor reason far more than we do force.

We favor reason because we want to avoid problems, not just clean up after them. We favor reason because we believe that reasonable bankers want to avoid problems, too. Working as a team, we can be far more effective in avoiding problems than we would be working as adversaries. In other words, we can leverage our resources with bank management's own desire to avoid problems. We believe this is the most effective way to use the regulatory tools that we have to promote a safe and sound banking system.

A friend of mine, an honors graduate of Texas Agricultural and Mechanical University, an "aggie," spent the first half of the 1980s lusting for a car phone. Finally, he convinced himself that it was a necessity, not a luxury, so he bought one. The day he bought it, he

called me from his car to tell me the news. And I didn't hear from him again for about a month.

Finally, I saw him on the street and he seemed really down in the dumps. I asked him what was wrong and he said it was the car phone. "What do you mean?" I asked. "You wanted that phone more than anything you ever did." And he said "Yeah, but it's wearing me down having to run to the garage every time it rings."

Regulations, like telephones, are instruments. They can be used effectively. They can be used adequately. Or they can be misused. They can be wielded — and redesigned — and complicated — or simplified — in any number of ways to achieve what you want to achieve. We can, using regulation, create a risk-free banking system. It would, however, also be a profit-free banking system. We don't think that a safe and sound banking system means having a risk-free banking system. Rather, it means having a banking system where the risks are properly balanced and managed. Our regulatory structure should be designed to achieve that end.

That's our approach to bank supervision and the philosophy that provides its foundation.

As I've said before, there is a great deal of rumor masquerading as fact and just plain misinformation circulating as gospel about the OCC's supervisory approach right now. Some people think that we are out to regulate banking markets by trying to shut off credit or limit the amount of credit going into specific uses. For example, it has been charged that the OCC wants to bring mortgage and construction lending to a halt, or at least slow it down dramatically.

That's simply not true. We don't regulate markets. Rather, we supervise institutions.

At the same time, it has been said that we want to bring bank lending to a halt in a particular region such as the Northeast or the Southeast.

Again, that's simply not true. We don't regulate regional portions of the industry. We supervise individual institutions.

If we wanted to do any of these things, we could adopt regulations limiting the amount of exposure a bank could take to an industry or a region; in effect, credit allocation. But that's not our job.

True, when we have found problems — in highly leveraged transactions, in consumer lending, in real estate — we have sounded warnings. But the warnings are warnings to take care, not to abandon the business entirely. Nothing is inherently wrong with any of these businesses, but something may be wrong in how any particular transaction is done.

Furthermore, we all know that some national banks in the Northeast, and particularly New England, have problems with their real estate loans right now, just as the real estate industry there is having problems because of oversupply and a weakening demand. But that isn't to say that all national banks there have these problems or that every real estate loan in the Northeast is bad. Far from it. We wouldn't say anything like that unless we had examined every real estate loan in every national bank in the region.

Our approach is to review every institution individually to check to see that management has the procedures, policies, and systems in place to manage properly and to check to see that problems have been addressed.

I would be less than frank with you if I tried to downplay that we've found problems or that the problems are significant. But the important point is that many of these problems, and their severity, are the result of poor management practices: specific people acting at specific institutions. Where we find specific problems we take specific action to resolve them. And we will continue to do so.

But we don't declare entire credit markets "off-limits" — nor do we ever intend to.

We recognize that, in the Northeast, in the Southeast, and elsewhere there are companies, industries, and economic sectors with problems. But it's not our job at the OCC to exacerbate their problems. And it's not our job to ameliorate them, either. It is our job to ensure that the national banks under our supervision don't end up having someone else's problem become their problem. It is our job to ensure that national banks have the types of managers and managerial processes that take into account the risks in any activity.

There is nothing inherently wrong with national banks' participation in real estate and construction lending in the Northeast, the Southeast, or anywhere else. I would say to any national bank anywhere that, if a real estate or construction loan makes good business sense and the lending is handled and reviewed with good managerial processes, you'll not find us raising supervisory objection. I would say, if the specific real estate or construction loan is justified, do it.

There is nothing inherently wrong with real estate or construction lending. There is nothing inherently wrong with dynamite, either. The problem comes in how you handle them. If you handle them with care — respect-

ing the potential damage they can cause you — you'll have no problem with them. If you handle them with care and for the uses in which they were created, both you and others will benefit. I would say, however, that if you handle them negligently or with reckless disregard, they can, and will, blow you away.

Not too long ago, a four-year-old boy we know told his father that he desperately wanted a baby brother or sister. His parents told him he should pray for one. He prayed hard one night, and the next morning — no baby. He prayed hard the second night, and the next morning — no baby. He prayed hard the third night, and still the next morning — no baby. Becoming discouraged, he stopped praying.

Several months passed and the boy's father took him to the hospital. A nurse brought out a baby boy and handed it to the father. A second nurse brought out a baby girl and let the grandmother hold it. And a third nurse brought out a baby boy and put it on the little boy's lap. Triplets!

The father asked his son: "Now aren't you glad you prayed?" And the little boy said, "Yes, but aren't you glad I stopped?"

I'm going to stop here with the hope that what I've said will beget some new thinking on your part and that it will lead to the birth of a more truthful understanding of what the OCC's supervision of banks is all about.

## Remarks by Robert L. Clarke before the Independent Bankers Association of America, on agricultural lending, San Francisco, California, March 10, 1990

It's true that we live in unprecedented times. Communism erodes around the world. Authoritarian dictatorships totter and fall like punch-drunk prize fighters taking a dive. Europe seriously undertakes an effort to join in a true common market. And the Comptroller of the Currency addresses the annual convention of the Independent Bankers Association of America for the fifth consecutive time, an event not only unprecedented, but unthinkable in just the recent past.

I'm happy to be a part of these times, and to be here with you in San Francisco. It is fitting that this organization meets in this city, the site of a heroic moment in community banking. In the early morning of April 18, 1906, this city shook with the reverberations of the worst earthquake in its history. One third of the city would soon be a smoking ruin. In his house 17 miles from San Francisco, A.P. Giannini, vice-president and founder of the tiny two-year-old Bank of Italy, was awakened by his house shaking.

It took him more than five hours to walk into town, where his bank had opened at nine o'clock. He kept it open until early afternoon, then took the remaining $80,000 his bank had on hand and hid it in a wagon under boxes of oranges. That night, he took the money home for safekeeping. And when he and the money returned to the city the following day, he found that fire had reduced the Bank of Italy's building to ruins.

Later, Giannini attended a meeting of bankers and business leaders near the city's waterfront. And there he told them: "Tomorrow morning I am putting a desk on Washington Street wharf with a Bank of Italy sign over it. Any man who wants to rebuild San Francisco can come there and get as much cash as he needs to do it."

The equipment of the wharf office, which remained in operation for three weeks, consisted of a plank counter and a bag of money. According to a history of the Bank of America, the giant multinational bank that grew from Giannini's independent, community bank: "A.P. did not need (records). He knew every one of his distressed clients and, almost to the penny, their balances before disaster struck. Moreover, he knew how much they could stand in the way of loans . . . . Six weeks after the earthquake, the Bank of Italy's deposits were exceeding withdrawals."

The Bank of Italy's heroic action in the Great San Francisco Earthquake reflects the virtues of independent community banking then, and now: an intimate knowledge of the customer and his needs, which leads to mutual trust and confidence.

I would hate to think that a bank examiner at the time would have responded to Mr. Giannini's actions by requesting — and then demanding — that the Bank of Italy establish policies and standards for lending, that it back up the lending process with loan documentation and analysis, that it establish systems of management and control so that its management would know the risk exposure of the institution. Had a bank examiner made those demands, it is unlikely that the Giannini story would have enriched banking history and folklore. After

at the earthquake and the catastrophic fire that followed it were an emergency. And Mr. Giannini was responding to the crisis in a responsible, if managerially unorthodox manner. Necessity demanded his actions. But, except for two or three times a century, banking in this country doesn't operate in the midst of crisis. And we're all very fortunate that these crises are so rare.

Bankers have the time — the leisure, really — to do the things that need to be done, as well as the freedom to leave undone the things a banker should not do.

My message today is not complex. But I do want to take the time to cover all of its supporting points. If I don't, I will run the risk of being unclear — like the bank teller in West Texas who asked a customer who wanted to cash a check: "Can you identify yourself?" The customer reached into her purse, pulled out a mirror, looked at it and said: "Yep, it's me, all right."

The last thing in the world that I want to be is unclear — so I've taken the time and made the effort to make my message today unmistakable.

What is my message?

The main lesson I've learned in more than four years as Comptroller of the Currency is this: Far, far too many bankers — and bankers from the largest institutions in this country to the smallest — manage their institutions with little or no regard for standard and enlightened managerial practices and thought. Because bankers fail to follow these fundamentals, money, jobs and reputations are lost. Because bankers fail to follow these fundamentals, businesses suffer and local economies decline. Because bankers fail to follow these fundamentals, banks founder — and far too many sink.

Banks don't fail. Bankers do.

The failure of bankers to follow the fundamentals is one of the reasons banks have had an extraordinarily difficult time making the case with the Congress for more competitive opportunities. Which ultimately makes it a matter of national interest because we are competing in a global economy. Historically, nations that have been strong economic powers have also had well-developed, highly competitive banking systems. If our overall economy is to remain competitive in international markets, so too must our banks. To be competitive with other global financial service providers, our banks must have authority to offer more services in their home markets.

What I find most frustrating, and even unbelievable at times, is that many bankers who fail to follow the fundamentals do so not out of ignorance, but out of hubris — that is to say, excessive confidence in their own ability, a tragic flaw if there ever was one.

I'm rarely at a loss for answers when someone asks me a question. After all, I am a lawyer by training and experience. We lawyers can almost always make up an answer, even if we don't know what the correct answer is.

But several weeks ago a financial writer from the Northeast asked me: "How can bankers still be in so much trouble from repeating the mistakes of other bankers when there has been so much evidence in the Southwest of the damage these mistakes can bring?" The answer I gave him was: "It's a mystery to me."

It is a mystery to me why bankers ignore the lessons of the past, lessons that whatever you cannot measure, you cannot manage. All the lessons of the past point toward one simple truth: management is a process, not an event. If managers don't manage, then who will?

In its most fundamental sense, the word "management" means one thing: maintaining control. To maintain control, management has to make decisions. To make decisions, management has to know what is going on in its institutions. Management also has to have the means to take action when it needs to. In other words, management has to know the condition of the institution — where the institution should be going — and how the institution should get there.

If management doesn't do these things, the institution will soon be out of control.

If you will remember, three years ago we did a study on national bank failures in the Midwest and the Southwest, where depressed conditions in agriculture, in energy, and in real estate had driven many banks into the ground. Yet, many banks in the same regions remained unbeaten. Some of those successful banks are owned and operated by members — and leaders — of this organization. Several banks we looked at actually improved.

We asked ourselves why the performance of national banks diverged so dramatically over a decade when they were faced with similar declines in their economic environments. The answer we found: Management.

Banking performance, good and bad, was primarily the result of managerial behavior, even in the most depressed economic environments. We analyzed virtually every national bank that failed in those regions over the decade under study. We found that the failed banks, as well as those that had significant problems,

consistently lacked policies, systems, and controls to guide their staffs in performing the necessary job of managing an income-producing institution.

Most failed banks either had no loan policies, or, if they had them, the policies were not followed. Most had inadequate systems to ensure compliance with either internal policies or banking laws. Most had inadequate controls or supervision of key bank officials or departments. And more than half had inadequate problem loan identification systems.

Here, the lessons of the past could not be clearer.

As you all know, the OCC is currently taking a very close look at the real estate portfolios of some of the larger national banking organizations back East that have large exposures to real estate. We are finding that history repeats itself. We've found that national banks with real estate problems evidence the same type of managerial flaws that we found in the bank failure study that we released two years ago: A failure to focus on fundamentals.

There is nothing wrong with real estate lending. Just as there is nothing wrong with the type of lending in which many of you concentrate, agriculture. There is nothing inherently wrong in either. But there may be a great deal wrong in how any particular transaction is handled.

The real estate slowdown in the East is, I am sure, a situation that many of you spend little time thinking about, if you spend any time thinking about it at all. But agriculture, I would imagine, is an activity many of you spend a great deal of time thinking about.

I urge you today to add to your thinking an extra dimension: What would you do if agriculture were to take a downturn again?

What prompts my concern is a study of risk guidelines and underwriting standards for agricultural loans made by national banks in the OCC's Midwestern District — Iowa, Kansas, Minnesota, Missouri, Nebraska, North and South Dakota — America's agricultural heartland — the place where disaster struck in the early 1980s, just about the time banks began to decline in the Southwest.

Our Midwestern District will release the complete findings of this study, which was based on the analysis of a large, representative sample of national banks in the district. The findings of the study are significant, so significant that we will soon publish them, because we want every national bank involved in agricultural lending in the Midwest to evaluate the strength of its policies and systems against the study's results

To give you an idea of what is coming I want to describe some of the study's findings for you today The kinds of weaknesses we identified throughout the study are weaknesses that historically have led to loan losses, problem banks, and bank failures in a deteriorating economy. I want to stress that 85 percent of the national banks in the Midwest that failed in the last decade were community agricultural banks that we believe did not properly manage their risks.

First of all, we focused on financial statements We found that all the banks surveyed collect annual balance sheets from their customers. In addition, nine out of ten banks collect cash flow statements; about eight out of ten verify cash flow assumptions. But about a third of the banks surveyed failed to investigate the reasons for material differences between projected cash flows and actual results — to look behind the financial statements.

Furthermore, nine out of ten of the banks surveyed used customers' tax returns as acceptable financial statements. Farm borrowers generally prepare tax returns on a cash basis. This is fine for tax return purposes. But a set of books put together on a cash basis can distort actual income measurement — tax returns that verify a borrower's positive cash flow are not necessarily a reliable indicator of the borrower's overall financial performance — and that is really the issue in assessing the financial condition of a bank or the loss in its loan portfolio.

To put it simply, accrual income information allows for greater accuracy and consistency when assessing financial performance.

Second, we investigated to see if banks engaged in financial analysis in their dealings with farm customers and, if so, how they used financial ratios. Our study found that most banks do not commonly use ratios to analyze the financial strength of their farm borrowers. And we found that many of those that do use ratios do not have internal standards governing how they are used. Most banks do commonly analyze certain measures of liquidity and solvency, such as the current ratio and debt-to-net-worth, and have established standards for the use of these ratios, but even these ratios are not in universal use.

Ratio analysis is important because, when used with other tools, it is an effective means of monitoring trends and significant changes in a borrower's financial condition. Ratio analysis of a customer's liquidity, solvency, profitability, repayment capacity, and efficiency give

the lender a much deeper knowledge of the customer than would otherwise be the case, knowledge that enables a banker to assess better how well a customer is prepared to withstand a business decline or a decline in the economy.

We also found that 79 percent of the banks we surveyed document a borrowers debt-to-net-worth ratio in their financial analysis. But only 60 percent of the banks using the ratio had standards for its use.

Third, we looked at loan administration, the policies and risk management controls governing agricultural loan portfolios. We found that 13 percent of the banks surveyed lack written guidelines for agricultural lending. We require banks to have written guidelines for a very important reason. As our bank failure study pointed out: "Banks are able to remain healthy institutions throughout economic fluctuations by establishing and maintaining strong internal policies, systems, and controls."

The banks with written policies that we looked at in the failure study were far more likely to survive economic downturns than the banks without such guidelines because such policies give banks one tool to control the exposure that comes from concentrating lending in credits that share a significant characteristic, be it loan type, terms, location, whatever — in other words, the opposite of diversification. Such policies provide guidance to lending staff; such policies also allow managers to be held accountable to the board of directors. All of these benefits from written policies become extremely important in an economic downturn.

We also found that loan administration all too often failed to provide sufficient protection to the institution because the information being given to loan committees was inadequate for the committees to make a reasoned and informed decision. Furthermore, some loan committees failed to consider relevant information. The loan committees at more than one-in-ten of the banks we surveyed failed to review the borrower's financial trends, thus depriving the loan committee of the ability to evaluate the financial progress or deterioration of the borrower. Furthermore, the loan committees at more than one-in-five of the banks we surveyed failed to review secondary sources of repayment, thus depriving the loan committee of assessing the risk present in loans if the primary source of repayment were to become impaired.

And more than half of the loan committees failed to assure that a borrower's request for credit complied with bank policy.

As I said earlier, loan administration needs to do a better job of looking at concentration in lending. Ninety-six percent of the banks we surveyed do not have guidelines for concentration by loan type. Seventy-two percent lack internal guidelines for or limits on total volume of agricultural loans. Sixty-two percent lack guidelines for tracking advances to borrowers and their related interests. And only 27 percent of the banks provide to their boards of directors information on concentrations of credit.

As we have seen time and time again, concentration of credit is a risk. It is a risk that can be controlled. But it can be controlled only if it is specifically identified and recognized.

In good economic times, operating weaknesses and asset quality problems are not as apparent as in weakening economies. The financial health of borrowers and growing local economies in good times mask the problems. When the economy declines, however, the failure to adhere to some of the fundamentals of lending — and to keep track of the financial fortunes of the borrower you lend to — can result in disaster.

All of banking, from the largest banks in the money centers to the smallest banks in America's heartland, is in the business of managing risk. If a banker isn't managing risk, what is he or she doing? Speculating that good economic times will continue to buoy up profits? Presiding over the demise of his or her institution?

I cannot say. But I can say that the bankers who believe that they don't need to make the effort to manage the future course of their institutions are precisely those bankers exposed to the greatest risk. The banker who looks at his institution and says "It can't happen here" is the banker who is most likely to wake up one morning and find that "it" did.

It's a matter of common sense, or realistically assessing the job to be done and determining the best way to do it effectively and efficiently. Anything else is nonsense.

I first learned the difference between common sense and nonsense when I was a young boy. I dropped by a ranch near where I grew up and found the rancher down at the barn sawing on a log that went above the door to his mule's stable. I said to him: "Why don't you dig the floor out? It would be easier than sawing that log."

And the rancher replied: "It ain't his feet that's blocking his way — it's his head."

Common sense means using your head as an asset, not a hindrance.

I've often said that bankers should manage as if there were no bank supervisors, and I don't mean that in the sense of complete license. Instead, what I am merely doing is pointing out that bank supervisors are tangential, management is essential. The risks, the losses, and the consequences of those losses will be there whether supervisors exist or not. It is the job of bankers and bank directors to identify the risks that can sink the institution and to do something about them.

At the OCC we recognize that we cannot manage, and we do not want to manage, much less micromanage, the institutions under our supervision. That's what bankers are for. Our mission — as we see it — is to assure that the institutions under our supervision have good management, managers with the intelligence and the foresight to create and maintain systems to measure risks and keep them under control. We check to see that management has the procedures, policies, and systems in place to manage properly, to see that management has a clear understanding of the risks it has taken, to see that problems have been addressed.

An effective management system does not have to be driven by a mainframe computer. A policy does not need to be a treatise. Policies should be guiding principles that produce the same approach to the business, whether the responsibility is being carried out by the chief executive officer or by the newest employee. And what we want to find is not stacks of loose-leaf notebooks filled with policies prepared by consultants or copied from competitors, but well thought out risk management standards and evaluation techniques that are appropriate for the risk profile of the individual bank and, most important, standards and techniques that work.

In other words, you have to be practical.

And what does being practical mean in practice?

Agents from the Treasury found out one day when they went to a house in Appalachia and asked a small boy where his daddy was. "Making moonshine," the boy said. "Where?" one of the agents asked. "I'll show you for ten dollars," said the boy. "Okay, let's go," said the agent in charge.

"Pay me first," said the boy. "No," said the agent in charge, "we'll pay you when we get back."

And the boy replied: "Ya'll ain't coming back."

Being practical means taking the actions that are realistic and necessary to achieve the desired result.

At the OCC we don't want to become involved in bank management. But, to avoid putting us in a position where we need to involve ourselves in the management of banks, bankers have to take responsibility for establishing and maintaining good risk identification and management policies and systems in their institutions.

In the future, you can expect to see us continue to act earlier to anticipate problems. In the future, you can expect to see us act earlier when we find problems at institutions. At the same time, we expect bankers to act earlier to address the problems in their institutions, too. We have a responsibility to meet. And so do you.

Today the virtues of independent community banking are the same as they were in 1906: an intimate knowledge of the customer and his needs, which leads to mutual trust and confidence.

There is no conflict between these virtues and the discipline of management. A banker can run a well-managed institution at the same time that he or she provides the benefits of independent banking to the community served by the institution.

It happens thousands of times a day, all throughout the country.

Even so, it doesn't happen as much as it should. As a result, bankers fail. Which is a shame and a waste. The lessons of the past are clear. They are also unforgiving.

If you haven't taken them to heart, I urge you to reflect upon this common sense observation by the governor of Kentucky thirty years ago, Governor Bert T. Combs: "You don't learn anything from the second kick of a mule."

As with most common sense, this observation may not appear earth-shaking, but heeding it may save you from catastrophe.

# Statement of Robert L. Clarke before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, on issues related to the Financial Institutions Reform, Recovery and Enforcement Act, Washington, D.C., March 14, 1990

Mr. Chairman and members of the subcommittee, I am responding to your request that I present my perspective on certain issues you have raised regarding the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). In particular, as you requested, I will comment on House legislative initiatives on restricting the sales of subordinated debentures in financial institutions and on restructuring the Office of Thrift Supervision (OTS).

The administration and Congress took decisive action seven months ago to enact sweeping legislation to respond to the problems in the savings and loan industry and its insurance fund. Therefore, FIRREA has a more direct impact on the operations of OTS and the Federal Deposit Insurance Corporation (FDIC). Nonetheless, FIRREA provided significant new responsibilities to all federal financial institution supervisors, including the OCC. As these new responsibilities are undertaken, and the changes made in law and practice are felt in the financial services industry, it would be premature to urge further legislation.

My testimony first describes the major activities in which we are engaged as a result of FIRREA, especially in the areas of enforcement and community reinvestment. I will then discuss my thoughts regarding the questions you raised in your invitation letter.

## OCC Projects Required by FIRREA

The OCC, as a result of FIRREA, is revising regulations and reporting requirements in approximately 15 areas and participating in the preparation of approximately 10 reports to Congress. These projects often are coordinated efforts, involving all of the federal financial institution supervisors. To give you some idea of the wide range of our activities and their current status, five of the largest projects underway at the OCC are described below. These projects demonstrate that much of our work is just beginning — we are in the process of coordinating policies with the other federal supervisory agencies, soliciting public comment on proposed rules, and clarifying the legislative interpretations through court cases.

### Changes in OCC Enforcement Provisions

The OCC has taken significant steps to incorporate the strengthened enforcement authority under title IX into our supervisory process. We are developing regulations and revising OCC policy statements, including those addressing our internal policies and procedures. We are also providing informal guidance to examiners, bankers, and bank counsel pending the final issuance of the regulations and formal statements of policy.

The OCC is working in consultation with the FDIC, the Board of Governors of the Federal Reserve System (FRB), the OTS, and the National Credit Union Administration (NCUA) to implement some of FIRREA's title IX provisions. An interagency working group is currently drafting guidelines to implement the civil money penalty provisions to reflect the increased assessment authority contained in section 907 of FIRREA. That group is revising the existing guidelines issued by the Federal Financial Institutions Examination Council (FFIEC), which sets forth the standards that are used to assess civil money penalties. In the meantime, however, the OCC will apply the increased civil money penalties, as appropriate, to all enforcement proceedings.

Another interagency working group is examining the desirability and feasibility of delegating enforcement authority to regional or district offices in preparation for the report to Congress required by section 917 of FIRREA. Prior to the enactment of FIRREA, the OCC had delegated considerable enforcement authority to its district offices. These delegations permit enforcement decisions to be made quickly by examiners and district office managers familiar with the condition and activities of the bank. Under our current delegation policies, the district offices have authority to initiate, negotiate, execute, modify, and terminate actions such as commitment letters, formal agreements, and cease and desist orders involving all community banks except those that are "5" rated, and to issue and negotiate civil money penalties in amounts under $10,000.

Of course, in areas where interagency coordination is not needed, the OCC has taken steps on its own to respond to FIRREA. For example, section 913 requires the appropriate federal banking agencies to publish and make available to the public final enforcement orders or any modifications or terminations of final orders. We are fulfilling these disclosure requirements by publishing listings of the final enforcement orders on a monthly basis in, *Interpretations*, an OCC publication. Our Communications Division also maintains a file of all

final orders, which are available for public inspection, and we provide copies of the orders to the general public upon request.

Another important part of the OCC's enhanced enforcement authority is the continuing jurisdiction provision in section 905. That provision allows the bank supervisory agencies to bring removal and civil money penalty actions against individuals for offenses committed while they were associated with an institution, even though they may have subsequently severed any connection with the institution or the institution may have failed. To date, we have reinstituted 17 actions against individuals pursuant to section 905 which may not have ben initiated without this authority. We believe that it will prove to be an effective and valuable aid in our enforcement efforts.

Section 914 of FIRREA requires that certain depository institutions and depository institution holding companies give at least 30 days advance notice to the appropriate federal banking agency of any proposed appointment to the board of directors or to the position of senior executive officer. If the appropriate agency determines that the competence, experience, character, or integrity of any nominee is such that it would not be in the best interest of the depositors or the public for the proposed appointment to go forward, section 914 grants the authority to issue a disapproval within those 30 days. The OCC has just published a temporary regulation implementing these requirements. The rule is effective immediately upon publication, subject to a 60 day comment period.

In addition, we are revising our internal policies and procedures to enforce FIRREA's reporting requirements. For instance, we are taking steps to implement the increased authority to assess civil money penalties for late call reports contained in section 911 of FIRREA.

We will submit our annual report concerning enforcement actions taken by the OCC, as required by section 918, to Congress at the end of the year. We are currently compiling statistics on actions that have been taken to date. In the report, we will also make recommendations for additional legislative initiatives that we believe are necessary.

### CRA Disclosure

FIRREA includes significant amendments to the 1977 Community Reinvestment Act (CRA). An institution's CRA rating based on an examination conducted after July 1, 1990 will be disclosed to the public. The existing five-tiered numerical rating system was statutorily revised under FIRREA to a four-tiered descriptive rating system. Federal financial regulatory agencies must also make available to the public a written evaluation of an institution's CRA performance which is based on 12 assessment factors which are included in the OCC's regulation implementing the CRA.

The OCC has been working diligently with the other federal financial supervisory agencies through the FFIEC to implement these requirements. On December 22, 1989, the FFIEC published in the *Federal Register* a "Notice of Request for Comment on the Uniform Interagency Community Reinvestment Act Guidelines for Disclosure of Written Evaluations and Revisions to Assessment Rating System." The notice represented the agencies' effort to develop uniform procedures for both the disclosure of CRA rating information and the standardization of written evaluation reports. The request for comment was intended to provide the public with an early opportunity to comment on the interagency proposal.

The FFIEC, through its Consumer Compliance Task Force, has retained a professional training consultant to develop the curriculum for a course for examiners on the new requirements of CRA. The training sessions will be offered during May 1990 and will be attended by examiners from each of the agencies. Experienced OCC national bank examiners from each duty station and field office will be attending this school. They, in turn, will be responsible for training other examiners in their respective field offices. We are also reviewing our CRA-related policies, procedures, and supervisory activities to ensure that we implement the CRA amendments in the most effective, efficient, and timely manner.

### Real Estate Appraisal Regulation

Title XI of FIRREA required that real estate appraisals used in connection with federally related transactions be provided in writing in accordance with uniform standards. Appraisers must have demonstrated their competency, and their professional conduct must be subject to effective supervision. Regulatory agencies are required to prescribe appropriate standards for the performance of appraisals in connection with federally related transactions. These standards should distinguish those appraisals requiring the services of a state certified appraiser from those that may be performed by an appraiser with only a state license, and identify real estate related transactions that require the services of an appraiser.

The OCC has published in the February 16, 1990, *Federal Register* a proposed regulation that would implement these provisions of title XI. The proposed regulation is the result of an interagency FFIEC effort

The FRB, the FDIC, the NCUA, the OTS, and the Resolution Trust Corporation (RTC) have issued substantively similar proposed regulations.

## Comparability of Employee Compensation

Title XII of FIRREA directs the Comptroller of the Currency to set pay and benefits of all OCC staff at levels comparable to those of the other federal bank supervisory agencies. The OCC took its first step to implement this provision on August 13, 1989. These initial adjustments are meant to target those groups of OCC employees with the most obvious pay gaps relative to other federal financial institution supervisors. As part of the interim adjustments, employees who work in certain high cost cities now receive a supplement to base pay. As a result, approximately 1,800 of the 3,250 OCC employees currently receive geographic pay differentials. Also, upper level management and 1,100 trainee-level employees received across-the-board pay increases to make their salaries more comparable to the other federal bank supervisors.

To further implement the compensation provisions of FIRREA, the OCC has retained a compensation consultant to assist us in ensuring that the OCC compensation program is comparable to those of other financial regulators. We expect to implement any additional changes to our pay structure after we have recommendations from the consultant.

## Comparison of Bank and Thrift Accounting Standards

FIRREA requires the OCC to report annually to Congress explaining any differences between its accounting standards and those used by other federal bank supervisory agencies. In addition, FIRREA requires OTS to conform its standards to generally accepted accounting principles and directs that these standards be no less stringent than those prescribed for commercial banks. The OCC is currently undertaking several projects to implement these requirements of FIRREA. In addition, the FFIEC has established a joint committee to resolve any differences in accounting standards.

The OCC follows generally accepted accounting principles (GAAP) except when significant supervisory concerns dictate more stringent standards or when GAAP does not address a specific accounting issue. For the most part, the regulatory accounting policy requirements for all commercial banks are prescribed in the Instructions to the Consolidated Reports of Condition and Income (Call Report) and apply to all commercial banks.

## The Need for Additional Legislation

As you can see from these descriptions, the OCC, like the other federal bank supervisory agencies, is engaged in a wide range of activities to implement the provisions of FIRREA. In working on these projects and the other projects required by FIRREA, we have encountered some language in the statute that has raised some concerns. No piece of legislation as broad reaching as FIRREA could be perfect. However, I believe that it is too soon to initiate modifications to the legislation. We continue to encounter new issues as we implement the provisions of FIRREA. Before considering new legislation, we need to be confident that we have identified all of the major issues. Until the federal bank supervisory agencies and the financial institutions have more experience with FIRREA, I believe legislative changes would be premature.

An example of the concerns we have uncovered is the following: FIRREA increased the maximum fine to $1 million for reporting fraudulent information in the quarterly report of condition required of all commercial banks. However, under the language of FIRREA, the fine applies only to banks filing fraudulent or intentionally misleading statements. The new fine does not apply to institutions that fail to file. The fine for failure to file has a maximum of $25,000 per day. Thus, a bank that does not want to reveal its true financial condition for some short period of time, for example, to allow time to raise additional capital, might choose not to file and pay the smaller fine. The larger maximum penalty should also apply to failure to file for such reasons.

Another concern that we have is with the language in section 217. This section allows the FDIC or the RTC to override state branching laws if a merger, consolidation, transfer, or acquisition involves an insolvent or ailing thrift. We believe that Congress intended that this provision apply to all acquisitions of savings associations and the Department of Justice has taken this position in court. However, a number of state commissioners have argued and one court has preliminarily ruled that, because of the language in the statute, the override only applies if the resulting institution remains a savings association. It does not apply to national banks acquiring ailing thrifts. These rulings have derailed a number of planned acquisitions and led a number of national banks to withdraw from the bidding for insolvent thrifts. This will only drive up the cost of thrift resolutions through delay and elimination of legitimate bidders. A clarification of the congressional intent would be useful.

As you know, we and the other federal bank supervisors have also encountered appeals for changes in major provisions of FIRREA. In our opinion, it is not clear

whether these appeals are justified because it is not clear that the legislation is the problem. For instance, concerns have been expressed about the requirement in FIRREA that the statutory national bank lending limit be applied to thrift institutions. National banks are generally limited by statute to lending no more than 15 percent of unimpaired capital and surplus to a single borrower and an additional 10 percent if secured by readily marketable collateral (e.g. U.S. government or other easily marketed securities). FIRREA added a new section 5(u) to the Home Owner's Loan Act ("HOLA") to apply this lending limit to savings associations "in the same manner and to the same extent as it applies to national banks."

This has resulted in a substantial tightening of the lending limit for thrifts. A savings institution, which prior to the enactment of FIRREA was permitted to make loans amounting to as much as 100 percent of capital to a single borrower, must now comply with the national bank limit of 15 percent of unimpaired capital and surplus. Furthermore, a thrift must now use the national bank definition of unimpaired capital and unimpaired surplus, which does not include goodwill or other intangibles, that were previously available to thrifts in defining their capital base for lending limit purposes.

Despite the fact that FIRREA carved out some specific exemptions that are not available to national banks, there is no doubt that the tightening of the lending limit has created some hardship. Since FIRREA was enacted last August, thrift representatives have urged the OCC to promulgate a transition rule delaying the application of the national bank lending limit to thrifts. We have not provided this relief because we do not believe that the OCC has the authority to delay the effective date of the provisions of FIRREA that impose this new limit on thrifts.

But it is also important to point out that a legislative change in the lending limit requirement is not the only way, and perhaps is not the best way, to solve the problem. The OCC's existing rules provide a number of options to institutions facing a reduced lending limit. We are assisting the OTS and the thrift industry to become familiar with the national bank lending limit statute and the manner in which it has been interpreted and applied.

The best solution to this problem may not be a legislative one or a regulatory one. For example, banks have traditionally sold participations in those portions of loans or loan commitments that exceed their lending limits. Banks have developed sophisticated distribution networks to facilitate the sale of participations. We see no reason why thrifts cannot do the same thing. Ultimately, this problem may be resolved when thrifts develop the same loan participation networks that have traditionally enabled national banks to participate in the funding of large scale projects.

Thus, from our experience, I believe that at this time it is inappropriate to make any major changes in FIRREA. We are too early in the implementation process to know which of the concerns encountered so far really requires legislative solutions. The financial institution supervisors and insurer should now be given sufficient time to implement the provisions of FIRREA, and the affected institutions should be provided with sufficient time to develop procedures to operate in this changed environment before any major revisions are instituted.

## Selling Subordinated Debentures on the Bank's Premises

The subcommittee also requested that I address pending legislation prohibiting sales by insured depository institutions of their own and their affiliates' securities. The apparent intent of current House legislative initiatives in this area is to prevent depository institutions' customers from being confused or misled when they purchase securities that are not deposits and are not protected by federal deposit insurance.

The OCC shares the subcommittee's concern with protecting bank customers from confusion in this regard. We have a number of safeguards already in place under existing law, regulations, and policy that are designed to minimize possible confusion to bank customers. For example, the OCC requires national banks to prepare offering documents to be issued in connection with the offering for sale of any of their own securities, and we review these documents for full and fair disclosure and compliance with law. With respect to offerings of national bank subordinated debt, the OCC currently requires a boldface disclosure on the cover page of the offering document that states that the securities are not deposits and are not insured by any government agency. Further, while we do not have a regulation dealing with this issue, the OCC has taken the position that national banks can only sell the commercial paper of their affiliates to sophisticated customers, such as institutional investors, and then only with full disclosure as to the non-deposit, uninsured status of the instruments.

We believe that, prior to enacting legislation, the bank supervisory agencies and the Congress should investigate this area thoroughly in order to better understand the extent and manner of conduct of these security sales practices and the incidence of abuse. We should be careful not to overreact to the well publicized abuses at Lincoln Savings and Loan. It may be that the

current rules together with strict enforcement and tough penalties are sufficient to get the job done.

The OCC is currently participating on an interagency task force with the other federal bank supervisory agencies to review current regulation of these sales. While it is premature to speculate on the findings and recommendations of the banking agencies, a number of possible regulatory solutions seem plausible if it is determined that bank customers need further protection from confusion on the nature of these sales. One possible alternative might be regulatory requirements to provide purchasers with additional disclosure as to the nature of the investment. Disclosure requirements might even extend to mandating that a purchaser, before ordering any purchase from a bank of the bank's own or its affiliates' securities, sign a simple declaration stating that the purchaser understands that the security being purchased is not a deposit and is not insured by the FDIC or any other government agency.

Legislation has been introduced on this issue by members of the subcommittee. A legislative solution imposing specific restrictions on financial institutions is certainly one approach if the facts support such action. However, passing the legislation may have unintended consequences, such as disrupting banks' capital raising and funding activities. Consequently, any restrictions must be narrowly drawn and carefully considered. Clearly, we want to protect customers from incomplete or inaccurate representations and from being misled. However, it has been our experience that small banks and minority owned institutions are most likely to rely on sales to the general public in their communities to support capital raising efforts. The approach adopted in the pending bills may have the unintended effect of unnecessarily restricting this traditional, legitimate avenue of capital raising for these institutions.

## Restructuring the Office of Thrift Supervision

Finally, you asked that I comment on the proposed legislation to restructure the OTS. I believe that, like other amendments to FIRREA, consideration of a merger of OTS with federal bank supervisors is premature at this time. Just last August, FIRREA consolidated the responsibility for supervising and examining savings and loans in one newly created agency, the Office of Thrift Supervision. Thrifts are operating under new regulations on capital, permissible activities, risk management, and loans to one borrower. The OTS is still establishing methods and an organizational structure to implement fully these new requirements. It is my understanding that the OTS is exploring ways it can improve its allocation of resources, property, and personnel.

The thrift industry is also in the process of a dramatic restructuring. Many thrift institutions are selling assets to meet the new thrift capital standards. Often, these assets are sold to commercial banks or other private parties, thus reducing the aggregate size of the thrift industry. In addition, the total number of thrifts continues to decline because of consolidation of the thrift industry and thrifts being purchased by and converted to banks. The remaining thrifts face economic pressures to expand beyond their traditional home lending activities.

While thrifts' non-real estate activities are now highly restricted by FIRREA, declining profit margins and the high interest rate sensitivity of residential real estate lending has led to a need for shifts in thrift activities. For example, thrifts are becoming major participants in the commercial real estate development business. Before a final determination on the need for or advisability of a merger is made, the thrift industry should have an opportunity to respond to the new competitive environment.

I am aware that legislation has been introduced that would shift the regulation of savings and loan institutions to the federal bank supervisors. Because they were so recently proposed, I have not yet fully reviewed and analyzed the proposals. As I said earlier, I believe it is premature to consider restructuring the OTS. However, as I stated in testimony last spring, I believe strongly in the separation of the roles of the insurer and the primary supervisor. If, at some future time, some of OTS's responsibilities were transferred to the OCC, we would have concerns about continuing the duplicative regulatory authority that the FDIC, as the insurer, has over thrifts. Under FIRREA, the authority of the FDIC over thrifts significantly exceeds that which the FDIC has over national banks.

Congress may, at some future time, decide, as a matter of public policy, that it is no longer necessary to maintain two types of insured deposit taking institutions. It is also possible that the thrift industry will evolve in such a manner that separate supervision will be inappropriate because the industry will be too small to support a separate supervisor. If either of these points are reached, then the restructuring of OTS should be considered. But, we are a long way from that point today.

## Conclusion

On all of the issues that I have discussed today, I have reached the conclusion that no changes to FIRREA are warranted at this time. All of the bank supervisory

agencies have much work to do. The supervisors and the insurer are still in the process of implementing many of the provisions of FIRREA; the Office of Thrift Supervision is still working to establish an efficient and effective regulatory structure; and the banking and thrift industries are still exploring the best ways to operate within the new environment created by FIRREA. It is appropriate for Congress to monitor the implementation of FIRREA to insure that the goals of FIRREA are being met. However, we need to wait until we have more experience before reopening the decisions made in FIRREA.

## Statement of Robert L. Clarke before the Subcommittee on General Oversight and Investigations, House Committee on Banking, Finance and Urban Affairs, on the General Accounting Office report on the securities activities of banks, Washington, D.C., March 19, 1990

### Introduction

Mr. Chairman and members of the subcommittee, I welcome this opportunity to comment on the issues examined in the report of the General Accounting Office (GAO) on the securities activities of bank holding company subsidiaries. They are vital issues, for their resolution will affect the future health of our financial system and its capacity to adapt to our rapidly changing times, and will determine how well our financial markets serve consumers of financial services. But we are not talking about anything new. These issues have been scrutinized over the last several years by members of Congress, by providers of financial services, by bank supervisors, and by academicians. They are made all the more important by the fact that our banks compete with more integrated and larger foreign banks.

These issues are before us today because of restrictions imposed by the Glass-Steagall Act — restrictions that limit the flexibility banks and bank holding companies have to respond fully to new market realities. In 1987, as the result of initiatives by a few large commercial banks, the Board of Governors of the Federal Reserve System (FRB) permitted nonbank subsidiaries of bank holding companies to engage in a limited number of securities underwriting and dealing activities, subject to numerous limitations. Even that modest step raised widespread expressions of concern, and at the behest of Congress, the GAO investigated the risk to banks and the public of these powers within the context of the limitations affecting their use.

I am heartened by what appears to be an acceptance by GAO, however qualified, of the appropriateness of these securities activities for bank holding companies. As I have testified on numerous occasions, I consider the relaxation of the statutory separation of commercial and investment banking a key element of a national strategy to keep U.S. banks and bank holding companies competitive, both here and abroad. Banks face increasing competition in their traditional lending markets from nonbank providers of credit as well as from foreign banks. In addition, advances in communication and computer technology enable an increasing number of bank customers to raise funds directly in the capital markets, thereby reducing their need for financial intermediation provided by banks.

I am concerned, however, that the debate over securities powers is being limited unnecessarily and inappropriately, and that many people are jumping to the conclusion that the corporate structure and the firewalls used by the FRB are the only ones that should be used. Models based on corporate separateness and firewalls provide a means of achieving greater competitiveness by commercial banks, but they are not the only models. I believe that effective protections can be provided in ways other than those adopted by the Federal Reserve Board. In my statement today, I will outline how an alternative, workable, and less burdensome structure for bank participation in securities activities can meet the important supervisory concerns that surround the exercise of securities powers. I will also address the question of the proper regulatory roles in maintaining firewalls.

### The Supervisory Response to Securities Activities

Permitting banking organizations to engage in a broad array of securities activities raises legitimate concerns about possible threats to bank safety and soundness and to the public interest. It has been argued that the

unfettered linking of commercial and investment banking would create increased opportunities for unscrupulous persons to endanger both banks and the public. The task facing bank supervisors and the Congress is to design a framework that addresses those concerns, without unduly restricting the ability of commercial and investment banking institutions to respond to the needs and opportunities of the marketplace. The framework currently in place, which the GAO describes in its study, has two basic elements. First, under FRB interpretations of the Glass-Steagall Act, securities activities that may not be conducted directly in a bank can take place in a separate subsidiary of the bank holding company. Second, the subsidiary bank and its securities affiliates are subject to a system of firewalls designed to prevent lending, funds transfer, the abuse of conflicts of interest, and other practices that could endanger the solvency of the bank. Let me turn first to the question of corporate structure.

## Separate Incorporation

The principle of corporate separateness is widely accepted as a means of addressing concerns over the safety of both banks and the customers they serve. Separate incorporation provides one way to apply current regulatory and market safeguards, such as limitations on affiliate transactions contained in the Federal Reserve Act. Corporate separateness, together with disclosure, is a mechanism for clarifying that securities of bank affiliates and other products sold by bank affiliates are not insured deposits. Corporate separateness can also facilitate competitive equity by ensuring that like firms are treated the same, regardless of their ownership.

The approach adopted by the FRB in granting authorization to engage in certain securities activities is to require the formation of a nonbank subsidiary of a bank holding company. It is important to note, however, that the bank holding company structure, which is unique to the United States, is not the product of market preferences. Moreover, there is no evidence that this particular corporate structure is unique in its ability to insulate, effectively and efficiently, a bank or the public from possible misdeeds by or losses of a securities affiliate. Indeed, the Federal Reserve Board recently authorized three foreign banks to establish securities affiliates as subsidiaries of the banks, noting that adequate protections could be established between the banks and their subsidiaries. Hence, the bank holding company structure, *per se*, is not critical.

If the use of bank subsidiaries is appropriate for foreign banks, why is it not appropriate for domestic banks? I have long advocated that we give careful consideration to a framework under which banks themselves could establish insulated subsidiaries to conduct a broad range of activities. Such an approach to reform could take advantage of the ample provisions in current banking and securities laws to protect both banks and the public.

To summarize, the public debate over securities powers for banks must give attention to the alternative means of implementing corporate separateness and to permitting banking organizations to choose the structure that best meets their needs. Firewalls that protect banks and the public can be adapted to the corporate structure chosen, without compromising protection.

## Prudential Regulation through Firewalls

A second key element in the current regulatory framework, also described in the GAO report, is the system of prudential regulation, commonly called firewalls. Generically, firewalls are intended to address two concerns: threats to bank safety and soundness, due to unsound lending and related funds-transfer practices; and threats to the public interest, through insider dealings, that are exacerbated when commercial and investment banking activities are conducted by affiliated firms.

We can trace the origins of the system of firewalls to the early 1930s and the many banking and securities laws that govern the conduct of competitors in our financial system. Those safeguards cover a wide range of topics from affiliate loans and asset sales to the public disclosure of insider and other interests. In earlier appearances before congressional committees, I have discussed those safeguards in some detail.

The firewalls the FRB imposed in its recent approvals for Section 20 affiliates are based on the statutory constraints. However, in some cases the FRB imposed requirements that go beyond those mandated by Congress. For example, in its 1989 decision allowing expanded debt and equity underwriting, the Federal Reserve Board banned the provision of credit by a subsidiary bank to an affiliated underwriting subsidiary. That goes far beyond the safeguards provided in sections 23A and 23B of the Federal Reserve Act, which, among other things, limit a bank's extensions of credit to a holding company nonbank affiliate to 10 percent of the bank's capital and require that transactions between a bank and an affiliate be conducted at "arms length."

The OCC recognizes an appropriate role for firewalls. We have previously discussed the use of firewalls in connection with our past proposals for reform of the financial services system. Section 23A, particularly as strengthened by section 23B, is a powerful tool for

regulating transactions with banks, and the regulators have established and used supervisory and enforcement machinery to ensure a high degree of compliance. However, we must pay careful attention to make sure that the costs and other disadvantages that result from firewalls are worth the protections they provide and to ensure that the requirements are clear and workable. We must not lose sight of the goal of financial services reform—a more efficient financial services marketplace through reduced restrictions on banks and securities firms.

We must also be prepared to accept the possibility that interpretations of the Glass-Steagall Act may not yield the level of participation by banks or bank holding companies in financial markets that our financial system requires. Under any reasonable interpretation of what it means for a securities subsidiary—of a bank holding company or a bank—to be "principally engaged" in activities that are prohibited for the bank, it may be that banking organizations cannot compete effectively. If that is the case, financial reform cannot be secured merely through regulatory and judicial interpretations of the Glass-Steagall Act.

### Maintaining and Supervising Firewalls

In addition to deciding on permissible corporate forms and appropriate firewalls, we must decide how firewalls will be maintained and supervised. Currently, with respect to operating subsidiaries of national banks, the OCC has the authority to impose and enforce firewalls in the form of conditions contained in approvals of applications to acquire those subsidiaries. FIRREA authorizes the OCC to assess civil money penalties against individuals responsible for violations of conditions contained in approvals. The possibility of such penalties, which can be substantial, significantly reduces the likelihood that a banker will choose to breach a firewall when a subsidiary faces difficulties.

The firewalls imposed by the FRB address transactions between banks and affiliated securities firms. As the primary supervisor of national banks, the OCC also has the ability to examine directly those transactions. In practice, we coordinate our examinations of the affiliates of a national bank with the Federal Reserve System, whose examinations of Section 20 subsidiaries focus primarily on the policies and procedures in place to avoid violations of firewalls. OCC examiners either work directly with Federal Reserve examiners, or pass on the results of our examination to them.

If a violation of the conditions of an order from the Board is uncovered, i.e., a firewall is breached, and that violation is found to represent an unsafe and unsound banking practice, the OCC itself can issue a cease and desist order against the national bank. Alternatively, the OCC can pass the information to the Federal Reserve Board, which could itself take measures to enforce compliance. Similarly, we make referrals to the Securities and Exchange Commission (SEC) when we obtain information that suggests that a bank affiliate is in violation of SEC regulations.

Supervising firewalls in a less restricted environment. If restrictions on affiliations between banks and securities firms were relaxed, the regulators of both banking and securities firms would have an interest in monitoring the transactions between the banking and securities entities. As the primary supervisor of national banks, the OCC, under its present authority, would continue to monitor the financial and other relationships between a bank and its securities affiliate to make sure that they do not endanger the safety and soundness of the bank. And the OCC would continue to make referrals to other regulators when there was reason to believe that violations had occurred related to their areas of responsibility. This supervisory relationship would exist regardless of whether the securities affiliate were a bank subsidiary or a holding company subsidiary.

## Conclusion

Mr. Chairman, the matters we have discussed today are vitally important, but they are not new. Bank supervisors must consider ways to provide protection against legitimate concerns that arise from the combination of commercial and investment banking activities. Corporate separateness provides a means of insulating insured deposits from new risks. However, I believe that the holding company structure is not unique in its ability to ensure the safety and soundness of banks and protect bank customers against abuses. Provided that those concerns are met, a bank should be free to select the form of corporate organization it finds most efficient. I also believe that firewalls are necessary to protect against certain abuses. Nevertheless, we need to examine them regularly to make sure they are no more restrictive than necessary to solve real problems.

I look forward to working with the Congress in forging new ground rules for competition in the financial services marketplace that will yield substantial benefits for all participants.

# Statement of Robert L. Clarke before the International Competitiveness of U.S. Financial Institutions Task Force, Subcommittee on Financial Institutions Supervisions, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, on the competitiveness of U.S. banks, Washington, D.C., March 21, 1990

## Introduction

Mr Chairman and members of the Subcommittee, I am pleased to have this opportunity to discuss global trends in the financial services industry and, in particular, the ability of U.S. banks to compete effectively in international markets. As the agency responsible for supervising national banks and federally licensed branches and agencies of foreign banks, the Office of the Comptroller of the Currency (OCC) is vitally interested in ensuring that national banks are able to be fully competitive in the constantly evolving international financial markets, and that the U.S. banking system remains safe and sound.

The OCC shares the Subcommittee's concern regarding indications of a decline in the position of the United States as a leading international financial center. At year-end 1988 (the most recent period for which statistics are available), the largest U.S. bank was ranked, in terms of assets, only 24th in the world; a decade ago, three of the top 25 banks, including the world's largest, were from the U.S.

This trend does not necessarily indicate that U.S. banks are becoming minor players in international financial markets. A bank does not have to be the largest in order to have considerable influence or to be an efficient competitor. There are a variety of explanations for the change in rank of U.S. banks, many of which are beyond the direct control of U.S. bank supervisors and lawmakers, such as exchange rate fluctuations and cultural differences. But part of the explanation lies in U.S. laws and regulations that are unnecessarily restrictive.

If U.S. banks and the U.S. economy are to remain competitive in international markets, it is essential to avoid encumbering them with costly restrictions on their activities that are not needed to ensure the safety and soundness of the U.S. banking system and the deposit insurance system. I am particularly concerned that some U.S. laws, such as the Glass-Steagall Act, may impair the efficiency of capital markets, and thereby raise the cost of capital for U.S. firms, especially small businesses that do not have direct access to capital markets. They may also raise the cost of capital for U.S. banks, placing them at a disadvantage in international markets and discouraging them from making the investments necessary to compete effectively for business overseas. Finally, by reducing competition among financial institutions, these laws may reduce the variety of services available to consumers and increase the prices that they pay for them.

The OCC has long supported initiatives to increase capital market efficiency by authorizing U.S. banks to offer a broader range of financial services. Some have argued that such expanded competitive opportunities would pose unacceptable risks to the banking system and the deposit insurance fund. I disagree. New powers are not synonymous with higher risk. Indeed, a less restrictive and more competitive system could be structured in a way that would properly limit the availability of the safety net provided by federal deposit insurance and the Federal Reserve's discount window, and require equity and debt holders to bear the risks associated with new activities.

In my testimony today, I will discuss what I perceive to be the major obstacles that U.S. banks will face as they seek to maintain a major role in worldwide financial markets in the near future. I believe that our system is in urgent need of reform, and my testimony outlines some of the changes I advocate.

## Evolution of Financial Markets

To a large degree, financial markets today transcend national boundaries—a sharp contrast to the fragmented markets of 10 to 20 years ago. Although banks have played an international role as facilitators of trade for centuries, their products usually have been tailored to meet the needs of domestic customers. In recent years, however, technological advances and the development of financial instruments that can be marketed globally have created opportunities for institutions with the networks and resources to operate in global as well as domestic markets.

Market integration favors institutions that can provide a wide range of products and services internationally. As both product and geographic restrictions are reduced elsewhere in the world, U.S. banks' foreign competitors are gradually becoming larger and more powerful. U.S. banks can expect competition from European financial institutions, Japanese banks, and from the emerging banking centers of the Pacific Rim, to intensify in the

1990s. That competition will be felt not only in overseas markets, but in the domestic U.S. market as well. The challenges that these trends present for U.S. banks may be increased if foreign currencies continue to appreciate, making foreign investments more expensive, while reducing the cost to foreign banks of investing in the U.S. market. In this environment, U.S. banks can ill-afford unnecessary statutory and regulatory obstacles.

## Full Participation of U.S. Banks in Global Markets

Integration of the European banking industry will expand the opportunities of U.S. banks to compete in the European market for financial services, but the degree to which U.S. banks can take advantage of those opportunities depends in part on steps taken to reform the structure and regulation of the U.S. banking industry. Although some differences in permissible powers among European Community (EC) member states remain, it is likely that all countries eventually will converge on the broadest set of banking powers allowed by EC rules. Members who retain more restrictive policies will discourage their own development as international banking centers and will handicap their banks in competing for business in other member states.

In sharp contrast to the continued progress toward financial market liberalization in Europe, the U.S. banking system remains entrenched in a restrictive structure developed over 50 years ago. The origins of the Glass-Steagall Act and other restrictions on banking powers are rooted in Depression-era concerns about the effects of large commercial or financial concentrations. By dividing the financial market into a number of distinct sectors and protecting each from competition, legislators hoped to prevent any one set of institutions from dominating the marketplace and wielding excessive power.

Although such an approach may once have been justified, it is clearly not productive in modern financial markets. Protecting markets from competition is not in the interests of financial institutions or their customers. Excessive concentrations of economic power remain a legitimate public policy concern, but it can be dealt with adequately under generally applicable antitrust statutes.

## A More Costly Corporate Structure

The U.S. requires a far greater degree of separation between commercial and investment banking than does virtually any other major banking power, except Japan; and Japanese authorities are currently evaluating proposals to reform its Article 65, which mirrors the Glass-Steagall Act. In practice, this separation is achieved through a corporate structure which is more complex than that of most other countries, and which increases the cost of complying with government regulation.

For example, under Federal Reserve Board interpretations of the Glass-Steagall Act, some securities activities that are prohibited for a bank to engage in directly can be conducted, to a limited extent, in a subsidiary of a bank holding company. Bank holding companies that establish such subsidiaries must also conform to a number of Board restrictions aimed at keeping those subsidiaries separate from the bank. The Federal Reserve Board, however, has not imposed the same restrictions on foreign institutions operating in the U.S. In a recent ruling on applications from Canadian Imperial Bank of Commerce, The Royal Bank of Canada, and Barclays Bank (United Kingdom), the Board treated these foreign banks as bank holding companies for regulatory purposes. The Board allowed those banks to underwrite ineligible securities through direct bank subsidiaries and, although the subsidiaries are subject to the same revenue limitations that U.S. Section 20 subsidiaries face, the provisions on lending and investment between the foreign bank and its securities subsidiary are less restrictive than those placed on U.S. banks.

## Restrictions on Activities

In addition to the higher costs associated with a more complex corporate structure, restrictions imposed by Glass-Steagall and Regulation K (which implements provisions of the International Banking Act of 1978) place U.S. financial institutions at a disadvantage in competing for customers who seek both commercial and investment banking services. Although U.S. banks are permitted to underwrite securities in some European countries and will be authorized to do so throughout the European Community after 1992, Regulation K, which governs the overseas activities of U.S. banking firms, stipulates that any single underwriting commitment may not exceed $2 million or represent 20 percent or more of the issuer's capital and surplus or voting shares. Furthermore, European banks face virtually no limitations on their ability to market U.S. or any other securities in European markets. In contrast, the Glass-Steagall Act restricts the ability of U.S. banks to market European securities in the United States, where their principal customer base is located. Access to a pool of investors is an important ingredient in successfully underwriting securities and typically requires a substantial commitment of time and resources. The difficulties involved in developing investor relationships with a new set of European clients could sig-

nificantly impede U.S. banks competing in the European securities market.

The extension of capital markets beyond national boundaries provides investors with a greater choice of instruments than was available to them when financial markets were less integrated and the transaction costs of making international investments were higher. Events in Europe, and movements in Japan to reform Article 65, provide additional motivation for the U.S. to consider the wisdom of some of its existing restrictions on bank activities.

In the absence of reform, U.S. banks will find it increasingly difficult to be active players in worldwide markets. If we continue to impose restrictions on our banks that hinder their ability to compete effectively in international markets, domestic firms that depend on U.S. banks for their credit needs could suffer. Under some circumstances, a U.S. firm might have difficulty obtaining all of the credit it needs for an oerseas investment or trade transaction if the U.S. banks with which it does business no longer maintain a presence in the foreign market in question.

## Expanded Powers, Diversification, and Safety and Soundness

Although many have expressed concern that granting new powers to banks may increase the risk faced by banks and the deposit insurer, new powers would not necessarily lead to greater risks. In fact, an investment bank typically serves as a middleman; its funds are not usually committed to an underwriting transaction unless someone in the syndicate fails to perform or if the transaction does not sell as expected. Thus, the investment bank is exposed for only a short period of time. In contrast, a commercial lender commits to provide funds over a longer term, thus bearing the loan risk over a period of time during which the fortunes of the borrower may change.

U.S. laws and regulations deal with the risk associated with securities activities by restricting the range of services banks and bank holding companies can provide and the conditions under which those services can be offered. It is important to realize, however, that restrictions on activities impose costs on our financial system. U.S. financial institutions cannot diversify over the full range of investments and financial instruments; various sources of income, such as fee income from securities activities, are severely limited. These restrictions also inhibit the ability of U.S. banks to adapt to changing markets. For instance, an increasing number of U.S. firms go directly to capital markets for financing. Only a few years ago those firms would have obtained their financing through bank loans. Because Glass-Steagall restrictions block participation by banks in much of the capital market activity, they have the effect of precluding banks from retaining these customers. This eliminates an important segment of the banks' traditional business and reduces the range of services available to consumers of financial services. Restrictions also have the effect of channeling banks into riskier product lines as lower risk customers solve their financing needs through other sources.

Many of the foreign banks that compete for this same business are not similarly restricted. West German banks, for example, can achieve a higher degree of diversification by holding equity securities, and Japanese banking firms have similar authority. To the extent that investors conclude U.S. banks are more risky as a result of more limited diversification opportunities, they will demand a higher return on their investments, increasing the cost of capital to U.S. banks.

Geographic constraints placed on U.S. banks also impair their efficiency. Although a number of state legislatures have taken the initiative in recent years to relax restrictions on branching and interstate banking, the legal structure of the U.S. banking system remains, on the whole, considerably more fragmented than that of virtually any other industrialized country. The removal of geographic barriers to banking would have several advantages. Most importantly, consumers of financial services would benefit from greater efficiencies in the provision of a wider array of financial services by banks. In addition, the removal of geographic barriers would reduce the vulnerability of banks to local economic shocks and make them less dependent on particular industrial sectors, reduce the competitive inequities between banks and other providers of financial services, which typically do not face similar geographic constraints, and facilitate the efficient flow of capital from areas of excess deposits to areas of excess loan demand.

One of the advantages of the banking structure that is being adopted throughout the EC is that it allows a high degree of product and geographic diversification. That is not to say that the banking structure that will prevail in Europe after 1992 will be fully adaptable to the U.S., and I am not advocating a hasty adoption of that model. There are significant differences between our financial system and the systems of some European countries. Those countries typically have far fewer financial institutions than the United States, a supervisor that has more involvement in the affairs of its financial institutions, and a system of deposit insurance with less explicit government guarantees. In addition, many aspects of the U.S. banking system have served us well. An increase in global competition may lead to some

consolidation and thereby increase the size of the largest U.S. banks. But I do not envision a diminution in the importance of community banks, which provide valuable services to their customers. As long as they continue to meet market demands, they will survive and prosper.

In recent years, the Congress has seriously considered a number of proposals that would improve the efficiency of U.S. capital markets by eliminating some Glass-Steagall Act restrictions. The OCC has strongly supported those efforts. It is my hope that recent changes in global financial markets will provide a strong impetus for the relaxation of restrictions on the permissible activities of U.S. banks.

## Towards International Supervisory Standards

In your letter of invitation, Mr. Chairman, you asked for my views on international trends in supervision. Providing better oportunities for U.S. banks to compete internationally will, no doubt, place greater burdens on the supervisors of U.S. banks. We must become more familiar with foreign markets, the activities of U.S. banks in these markets, and the risks inherent in these activities. But these tasks are not new to the OCC.

The OCC began a regular program of annual examinations of the overseas offices of national banks in 1965. We established a London office in 1972. Staff assigned to our London office routinely examine the London and major European operations of national banks. We also conduct on-site evaluations of the operations of national banks outside of Europe. Through our supervision, we seek to ensure that a bank has instituted proper controls and safeguards to manage its international exposure. We also conduct examinations that are targeted to particular activities, such as foreign exchange trading. Since January of 1989, we have conducted on-site examinations of the operations of 51 overseas offices in 11 countries.

Regulatory authorities in the U.S. and abroad have also recognized the need to coordinate regulatory standards as the barriers defined by national boundaries erode. The OCC is actively engaged in the efforts of the Basle Committee on Banking Supervision to coordinate supervisory standards in order to achieve a level international playing field in this area. (The Basle Committee has members from twelve countries: the United States, Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, and the United Kingdom.)

The Basle capital agreement is perhaps the most notable international supervisory achievement to date. This agreement, entitled "International Convergence of Capital Measurement and Capital Standards," was adopted by the Basle Committee on Banking Supervision in July 1988 and establishes a common risk-based capital framework, and minimum standards for all banks. It is encouraging to note that other countries—notably Australia, Israel, New Zealand, and most of the offshore centers including Hong Kong and Bahrain—have also adopted the Basle framework. In addition, countries of the EC that are not members of the Committee will be bound to the EC Capital Directives, which generally conform with the Basle agreement. The OCC, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision are implementing risk-based capital standards for all banks and thrifts, thereby assuring more equitable competition among domestic institutions.

International cooperation goes beyond agreements on capital standards. For example, in December 1988, the Basle Committee adopted a "Statement of Principles for the Prevention of the Use of the Banking System for the Purpose of Money Laundering." This statement encourages banks in the G-10 countries to establish policies and procedures to ensure: (1) the proper identification of all persons conducting business with the institution; (2) the conduct of the bank's business with high ethical standards; (3) cooperation with law enforcement authorities within the confines of applicable law; and (4) proper staff training in all matters concerning the statement of principles. The OCC has provided a copy of this statement to all national banks and encouraged them to maintain policies and procedures consistent with these principles.

Achievements to date have set the stage for further supervisory convergence in the years to come, through the Basle Committee and other groups. European integration will result in common rules and supervisory standards in a number of areas besides capital. Although the issues are difficult, the OCC is optimistic that progress towards common standards, where appropriate, will continue to be made.

Notwithstanding these accords, there will continue to be important differences in the ways that banks in each country are regulated, which will affect their costs and profitability. The varied history of activities, ownership, accounting standards, and financial intervention makes some differences inevitable. For example, accounting and tax treatments of the allowance for anticipated and unanticipated losses vary widely among countries. Some foreign banks have so-called "hidden reserves" which permit them to shift the timing of their recognition of losses and reduce the volatility of reported earnings.

## Conclusion

If the U.S. does not fundamentally change the way it regulates its financial markets, we are likely to find in a few years that we are the only G-10 country that maintains a separation between commercial and investment banking. This separation handicaps our domestic markets by perpetuating a less efficient system of capital distribution to the detriment of bank customers. In addition, our financial institutions will be hindered in their efforts to compete with their foreign counterparts. Both of these factors argue in favor of a comprehensive reexamination of the segregation of our financial services industry.

Clearly, we will need to retain the safeguards needed to protect banks and their customers; but we should not impose any more restrictions than are necessary to address real problems. I am confident this can be done while enabling U.S. banks to continue to play a significant role in global financial markets.

# Remarks by Donald G. Coonley, Chief National Bank Examiner, before the Urban Bankers Forum, on recourse arrangements, Detroit, Michigan, February 1, 1990

To be invited to speak to any group once could be merely a mistake on the part of the program chairman. However, to be invited twice to speak to the same group is a great honor. A return performance — here or elsewhere — is not always automatic. And Winston Churchill once used this fact to his advantage.

Churchill received an invitation from George Bernard Shaw to one of his opening plays back in the early 1900s. Shaw's note read: "Enclosed are two tickets to the first-night performance of a play of mine. Bring a friend — if you have one."

Not to be outdone, Churchill shot back this reply: "Dear G.B.S., I thank you very much for the invitation and the tickets. Unfortunately, I am engaged on that night, but could I have tickets for the second performance — if there is one?"

I am happy and honored that there is for me a second performance before this group. And I am pleased to be back here in Detroit.

After I received your invitation, I decided to do some casual reading on Detroit, and I found an interesting fact: the name comes from a French term "Le Detroit," meaning "the strait," or "the narrow."

The French, the first Europeans in the area, used the term to refer to the body of water connecting Lake St. Clair and Lake Erie. When the English took over control of Michigan from the French, they must have looked at "Le Detroit" and decided that it looked like a river to them, so they renamed the waterway by bringing the French name together with the English term and ended up with Detroit River — a misnomer.

It is a misnomer because to call the waterway the Detroit River is the same thing as calling something the Piedmont Mountains or the Peninsula Island — it is either one or the other but it cannot be both. Which just goes to show you how little the English knew about the strait and narrow.

History doesn't reveal the details of just how the misapplication of one term to another came about. However, we do have the story of how a similar misnomer came about in a similar situation.

Just as with Michigan, the first Europeans to survey upstate New York were the French. It should come to you as no surprise, then, that the Native Americans, the Indians, in upstate New York learned French as their first European language.

Indeed, the Indian confederacy that inhabited the area is even today called Iroquois, a French pronunciation of an Algonquian word, which reflects the early French influence.

The French, however, were soon followed by the English. And one day an English explorer and his Iroquois guide walked over a hill and saw a beautiful, pristine blue, body of water sparkling on the horizon — a creek running into the Niagara River. "What's that?" the English explorer asked his guide.

"*Belle fleume*," replied the French-speaking Iroquois, meaning beautiful stream.

"Boof-flo?" said the English explorer, "it doesn't look like a buffalo to me, but you live here and you should know — if you call it buffalo, we'll call it buffalo."

And so they did, extending the name to the settlement that later rose near the stream: Buffalo, New York.

Well, I didn't believe it the first time my Uncle Ned told it to me either.

But I recently came across a highly similar story in *Myth Information*, a book by J. Allen Varasdi.

Seriously, though, what we call things, and how we define things we give names to, is one of the most important activities we do.

In defining concrete things and abstract concepts, what we are doing is setting the limits and establishing the rules of how we are going to think about — and deal with — them later. Later actions rest on our earlier rigor in our thinking and precision in our words. I'll return to this important point in a few minutes. But first I want to describe briefly what I do as the chief national bank examiner of the Office of the Comptroller of the Currency.

That's some title, right? Chief national bank examiner of the Office of the Comptroller of the Currency. You ought to try to get it on a business card sometime. Or write it in those little, tiny spaces on application forms under Occupation. It reminds me of why one state back East calls itself "The XXXXXX State." They couldn't get "World's Largest Toxic Waste Disposal Area" on a license plate.

Do I enjoy being called by my title?

No.

I much prefer "Your Excellency," "Your Highness," or the short, simple, endearing, "Boss."

But the fact beyond the title is that I am the transfer point, the pivot, the level of middle management where the demands from policymakers — let's call them the General Staff — are fleshed-out and communicated to the agency's approximately 2,400 examiners outside of Washington — and let's call them the troops in the field. In other words, I occupy the point where theory is translated into practice.

It may come as no surprise to you — many of whom I am sure are in the same type of jobs as mine is — that the generals and the troops approach things differently.

The job of generals is to focus and develop the big picture — strategy — which is a word that comes from the Greek and means "the stuff that generals do." They are thinking about how to win the war.

The troops, on the other hand, focus on taking the very concrete objective in front of them.

Because I live between the two, I am quite sensitive to how different theory is from practice and to how difficult it is to translate one into the other.

Let me give you an example.

This guy at the country club is beating everybody on the golf course. Why? He's a big, strapping guy, a former professional football player, and he really can hit the golf ball. He's got all the other guys down about losing and he's bragging about how good he is all the time. Finally, one guy comes up with a theory on how to beat the guy. The theory? Find a golfer who is even bigger.

So he looks and he looks and one day he reads about an animal trainer who has taught a gorilla how to play golf. So he calls up the trainer and makes a deal to bring the gorilla to the club. And he asks the trainer: "Now, is this gorilla really that good?" And the trainer says: "Good? He can hit a golf ball 450 yards."

So the next week the gorilla and the trainer show up and the match is set up with the club champion.

The gorilla picks up a driver and tees off and, true to theory and the claims, the ball sails 450 yards through the air and drops four inches from the cup. The club champ is dumbfounded and in shock. The other players are ecstatic and jumping up and down with joy. The caddy then hands the gorilla a putter. The gorilla swings and hits the ball 450 yards!

Perhaps another, example will make my point even clearer. In the small town where I grew up there was a family in the Baptist church with the reputation of being the poorest family in the county. One Sunday, the family just stopped coming to church. After a couple of weeks, the preacher had a theory that the family was so ashamed of the way they dressed that they didn't want to come out into public.

So the preacher put out the word to his congregation that he needed clothing for the family and got some real nice children's clothes and some for the mother and the father, too. He took the clothes down to the family and they seemed grateful. They said they would come to church the next Sunday.

But Sunday rolled around and they weren't there. Sunday afternoon, the Baptist preacher went to see them and asked: "Where were you this morning?"

And the man of the house said: "Well, preacher, we got all cleaned up and got on those nice clothes you brought, and we looked so good we decided to go to the Episcopal church."

Now, as these examples illustrate, there are lots of glitches with putting any theory into practice successfully, glitches that include making sure the theory is sophisticated enough to adequately solve the problems at hand without its creating new problems. Whenever the OCC — as a bank supervisor — develops a new regulatory approach it is translating a theory into practice. When we are developing a new regulatory approach, what we are constantly trying to achieve is to solve the problems at hand without creating new problems.

In conjunction with our colleagues at the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of Thrift Supervision, we are currently trying to iron out such a new thrust in regulation.

And one reason I am here tonight is to ask you to help us in our effort to find solutions without creating new problems.

The subject of our effort will affect every financial institution represented in this room tonight, as well as virtually every depository institution in the country. That subject can be summed up in one word: recourse.

Our sister supervisory agencies have joined with us in an ad hoc task force — a special year-long effort — to address recourse-type enhancements used by depository institutions when they engage in asset sales and asset securitizations.

As I'm sure you all know, asset securitization was one of the major hot spots in banking over the last few years. Banks have sought to securitize their assets for any number of reasons, the major ones being reducing the need for capital, increasing liquidity, and reducing the total amount of outstanding loans to an individual borrower. We've seen asset sales and securitization in housing loans climb to very high levels over time, and the same process occurring later with credit card and other consumer loans. At the OCC, we expect commercial and industrial loans, and other types of loans, to follow.

Although asset securitization is nothing new, some time ago we at the OCC observed an increasing use and variety of recourse arrangements in asset securitization programs. In its simplest terms, "recourse" refers to the acceptance, assumption or retention of some or all of the risk of loss generally associated with the ownership of an asset. Recourse is not necessarily a function of prior ownership of an asset. Nor does it arise only as an incidence of an asset sale. For example, an individual or company may accept recourse as part of a contractual pooling or servicing arrangement.

In general, we've observed three forms of recourse arrangements in the banking industry. The first is traditionally a clear, straightforward, formal agreement by a bank to cover some portion of the risk of credit loss in the sale or securitization of its assets. More recently, these types of agreements — these seller assurances — have been expanded to cover other types of risk, including interest rate and prepayment risk, foreign exchange risk, risks associated with statutory or regulatory noncompliance, and so on.

The second form of recourse involves warranties or representations. Traditionally, seller warranties and representations have addressed items tat have been totally within the control of the financial institution; that a loan is not delinquent, for example, or that it is in compliance with federal consumer protection laws on the date of sale. But recently we've found investor demands that cover events or occurrences over which the seller may have no control; for example, guarantees of borrower compliance with environmental, health, and safety laws. And the favorite example of everyone familiar with recourse: sellers in California mortgage securities transactions have been asked to set up "earthquake reserves" to cover potential problems there, thus giving new meaning to the popular question — "What's shaking in the housing market?"

Clearly, these events are not under control of the seller.

Third, and finally, one may think of implicit recourse — recourse that does not result from any express or contractually binding agreement between a selling financial institution and the investor in a loan portfolio. Rather, effective recourse may result from the behavior of a financial institution subsequent to its sale of assets.

For example, an institution may seek to bail out a souring securitized loan issue originally structured on a nonrecourse basis to protect its relationship with a particular investor or to protect its reputation with investors or with the public generally. Or a bank may value particular borrower relationships and may subsequently repurchase these borrowers' loans from a pool if it judges them to be having temporary difficulty making loan payments as originally scheduled.

It is clear to all of you, I would think, why the OCC would be interested in recourse. Assuring capital adequacy of national banks is part of our responsibility as supervisors. Our risk-based capital guidelines embody the principle that the credit risk of each asset, whether or not the asset is carried on the balance sheet, requires capital support consistent with that exposure.

Even more fundamentally, part of our mission is to ensure that banks operate in a safe and sound manner. To ensure that banks do so, we must first ensure that the quality of bank management is adequate to do the job that has to be done. What you cannot measure, you cannot manage. We are concerned that bankers may not have a sufficiently sophisticated measurement of what risk their institutions' recourse holds for them.

Banks must know their risk to meet capital requirements. Banks should know their risk for safety and soundness reasons.

Because recourse arrangements expose a bank to the risk of loss, the OCC believes that these arrangements should be supported by capital.

While this position is not new, given the growth in recourse arrangements, the creative permutations in these arrangements and our risk-based capital standards, we believe that it is time to reconsider how our regulations treat recourse arrangements, which we have not comprehensively addressed before. In conjunction with our sister agencies, we are considering a regulatory definition of "recourse arrangement;" the appropriate method to determine the capital support required for recourse arrangements; and the appropri-

are way to capture a recourse arrangement for lending limit purposes.

To focus on the regulatory definition for just a moment, let me ask how wide should that regulatory definition be? Should implicit recourse be included in it? Remember, definitions are important because they shape our subsequent thoughts and actions.

In short, we need a definition that is broad enough and flexible enough to grow with the continuing evolution of asset sales, but one which won't, in and of itself, cause further problems. We are aware that the way we treat recourse arrangements in the future will affect the way in which national banks structure their asset sales and pooling and servicing contracts. We also recognize that the sales and securitization programs may be beneficial to a bank by providing it with a method to restructure its balance sheet and an option in funding. So while we don't want to impose unnecessary competitive burdens on national banks, we do want to ensure that our banks maintain adequate capital and that they monitor their exposures to operate safely and soundly.

So in conjunction with our sister agencies, sometime in February we will send to the *Federal Register* a solicitation for your thoughts and experiences — information we can use in developing a rational approach to recourse arrangements. We have targeted December 31 as an implementation date for any changes we will make in our treatment of recourse arrangements, a date that coincides with the implementation of the OCC's risk-based capital guidelines.

I urge you and your colleagues in the banking industry to give this issue some thought. And I urge bankers to give us the benefit of your thinking after reading and considering what we will have to say in our *Federal Register* notice.

I went into my subject tonight far more than I originally intended to do, but at least in doing so I've probably made you all feel like royalty for the evening.

"How's that?" you may ask.

The French court of King Louis XVI often had the honor of having the famous Father Jean Maury preach before them. After one of Father Maury's homilies, the King was asked his opinion. Louis XVI replied: "If the abbe had only said a few words about religion, he would have covered every possible subject."

## Statement of Paul Allan Schott, Chief Counsel, before the Subcommittee on General Oversight and Investigations, House Committee on Banking, Finance and Urban Affairs, on national bank lending limits, Washington, D.C., February 7, 1990

### Introduction

Mr. Chairman and members of the subcommittee, I am pleased to have this opportunity to present the views of the Office of the Comptroller of the Currency (OCC) on the national bank lending limit and to address the issues that have been raised by the application of this limit to savings institutions through the enactment of section 301 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).

My testimony is divided into four parts. First, I will briefly summarize the purpose and history of the lending limit for national banks. Second, I will describe the manner in which the national bank limit was made applicable to thrifts by FIRREA. Third, I will discuss the impact of the national bank lending limit regulation on lending transactions by institutions with a declining lending limit. Fourth, I will describe the OCC's understanding of the regulatory framework created by section 301 of FIRREA and discuss the OCC's authority as the supervisor of the national banking system to promulgate regulations applicable to savings institutions.

### Purpose and History of the National Bank Lending Limit

A maximum limit on the amount of credit that a national bank may extend to any one borrower has been in place since the establishment of the national banking system in 1863. Although there is little documentary evidence regarding the legislative purpose which originally prompted Congress to enact this limit, it is currently recognized that the lending limit promotes bank solvency and stability by requiring diversification of credit risk. Without diversification of risk, a bank's fate may rest in the hands of one or a small number of borrowers.

First enacted as part of the National Currency Act, the national bank lending limit was modified and incorporated into the National Bank Act in 1864. For the next one hundred and eighteen years, a national bank was generally permitted to lend no more than 10 percent of its capital to a single borrower, although during this period Congress added a number of exceptions for certain classes of loans. This basic rule remained law until 1982, when it was modified by the Garn-St Germain Depository Institutions Act.

The Garn-St Germain Act amended the lending limit statute (12 U.S.C. 84) to raise the basic limit that a national bank may lend to a single borrower from 10 to 15 percent of unimpaired capital and unimpaired surplus. The act also created a secondary limit, permitting an additional 10 percent of a bank's unimpaired capital and unimpaired surplus to be extended for a loan fully secured by readily marketable collateral. Further, the act modified and consolidated the lending limit exceptions for certain classes of loans, and delegated to the Comptroller of the Currency rulemaking authority to implement the statute. This delegation included explicit authority to issue regulations defining terms and establishing limits "other than those specified" for "particular classes or categories of loans," and to determine when loans to separate borrowers should be combined for lending limit purposes.

In 1983, the OCC promulgated final regulations in 12 CFR 32, implementing the amended statute. On October 24, 1989, following an extensive review of this regulation, the OCC published for comment a proposed rule that would revise the lending limit regulation. *See* 54 *Fed. Reg.* 43,398. Over 40 comment letters have been received and are being considered. The proposed rule is intended to clarify and simplify the existing regulation and to emphasize the core policy of the lending limit: the need to diversify risk in bank loan portfolios.

## Application of the National Bank Lending Limit to Thrifts

Section 301 of FIRREA added section 5(u) to the Home Owners' Loan Act of 1933 (HOLA), requiring that the national bank lending limit statute, 12 U.S.C. 84, shall apply to savings associations "in the same manner and to the same extent as it applies to national banks." The new section 5(u) of HOLA also contains several lending limit provisions tailored to apply only to thrifts. In some cases these special provisions have the effect of making the thrift lending limit more liberal than that for national banks; in other cases, the effect is more strict.

For example, one of the HOLA provisions permits a savings association, regardless of its capital, to make loans of up to $500,000 to one borrower for any purpose. Another provision permits a savings association to extend credit for the development of residential housing units in amounts up to the lesser of $30 million or 30 percent of the thrift institution's unimpaired capital and unimpaired surplus, if certain requirements are met. By contrast, the national bank lending limit restricts a national bank to making loans of 15 or 25 percent of its unimpaired capital and unimpaired surplus, but does not provide for an alternative dollar amount that may be extended to a single borrower without regard to a bank's capital base. Hence, in these areas, thrifts have more permissive rules, tailored to address those areas Congress identified as appropriate for differential treatment.

Congress also permitted the Director of the Office of Thrift Supervision (OTS) to impose more stringent restrictions on a savings association's loans, if the director determines that added restrictions are necessary to ensure safety and soundness.

As a general matter, putting aside the impact of the special rules in HOLA, the overall impact of section 5(u) resulted in a substantial tightening of the lending limit for thrifts. A savings institution, which prior to the enactment of FIRREA was permitted to make loans amounting to as much as 100 percent of capital to a single borrower, must now comply with the national bank limit of 15 percent of unimpaired capital and surplus, and an additional 10 percent for loans secured by readily marketable collateral.

Furthermore, a thrift must now use the national bank definition of unimpaired capital and unimpaired surplus to define its capital base for lending limit purposes. Previously, a thrift was permitted under Federal Home Loan Bank Board regulations to include goodwill in its calculation of capital. Now, under the national bank regulation, a thrift may not include goodwill as part of its unimpaired capital and unimpaired surplus in calculating its lending limit. These changes in the thrift lending limit have caused some dislocation in thrift-customer relationships because some borrowers are finding it difficult to obtain credit from their traditional sources.

## Impact on Current Lending Transactions of a Reduction in Lending Limit under the National Bank Lending Limit Rules

Let me take a moment to discuss the manner in which national bank lending limit rules operate in circumstances where an institution's lending limit has been reduced. First, national bank regulations provide that the legality of a loan under 12 U.S.C. 84 is determined at the time the loan is made. Thus, a new loan

must comply with the institution's lending limit on the day the loan is made.

Second, a loan that is in compliance with the lending limit when made does not become a violation even if the bank's lending limit declines during the original term of the loan. In addition, if a bank has exercised its best effort to bring the loan into conformance with its lending limit, it may renew or restructure the loan, as long as no new funds are advanced by the bank to the borrower or a new borrower is not substituted for the original obligor. This is because the advance of new funds or substitution of obligors is considered to be a new loan for lending limit purposes.

Third, a loan commitment, which when combined with other loans to the same borrower was within a bank's lending limit at the time the commitment was made, can be funded during its original term, even if the bank's lending limit declines. (Thus, under the national bank lending limit provisions, a thrift that made a commitment prior to August 9, 1989, which together with its other loans to a borrower was within the 100 percent lending limit, could legally fund that commitment during its original term, notwithstanding the new thrift lending limit imposed by FIRREA.)

However, the expiration of a loan commitment, whether unfunded or partially funded, or any restructuring of the commitment, presents a bank with the opportunity to bring the loan commitment into conformance with the bank's then-applicable lending limit. Thus, an unfunded commitment, or the unfunded portion of any loan commitment that would exceed the bank's lending limit if made on the date of renewal, may not be renewed.

Banks operating under these lending limit restrictions have learned to sell participations for those portions of loans or loan commitments that exceed their limits and have developed distribution networks to facilitate such sales. As a supervisory matter, we require institutions purchasing participations to perform an independent assessment of the underlying credit.

## Division of Regulatory Responsibilities under FIRREA

Section 301 of FIRREA generally makes thrifts subject to national bank lending limit standards by amending HOLA to provide that the preexisting bank statute, R.S. 5200 (12 U.S.C. 84), shall apply to every savings association "in the same manner and to the same extent" as it applies to national banks. Senator Riegle, Chairman of the Senate Committee on Banking, Housing and Urban Affairs, provided some insight into the meaning of this provision in a statement published in the *Congressional Record* on August 4, 1989. He said:

> [t]he bill generally makes savings associations subject to the statutory limits on loans to one borrower [the lending limit] that apply to national banks. In determining whether a savings association complies with the statutory limits applicable to national banks, the Director of the Office of Thrift Supervision will be bound by the regulations, rulings, and other interpretations of the Office of the Comptroller of the Currency, including definitions. The bill permits the Director to impose more stringent standards, but not to abridge the application to savings associations of the national bank limits.

To date, OTS has issued several thrift bulletins directing savings associations to apply the OCC's lending limit regulation and codified opinions, including the OCC's definition of unimpaired capital and surplus at 12 CFR 3.100. In addition, OTS has notified thrifts that the OCC's legal interpretations of the national bank lending limit statute will be given substantial weight.

In the United States, the financial regulatory structure is such that several agencies can be responsible for the supervision of depository institutions. While there frequently is an overlap of jurisdictions, Congress has at times designated a single regulator to prescribe rules and regulations to interpret a given statute. In such cases, each of the regulators charged with enforcing the statute can look to a single set of standards for guidance. For example, Congress gave the Federal Reserve Board authority to issue rules and regulations implementing the statutes governing transactions of Federal Reserve member banks with their affiliates, 12 U.S.C. 371c, and loans by member banks to insiders, 12 U.S.C. 375b. The OCC, as the supervisor of the national banking system, is charged with enforcing these statutes for national banks. In fulfilling this responsibility, the OCC has relied upon the Federal Reserve Board's rules, regulations, and interpretations through which the Board has elaborated on the requirements of these statutory provisions.

With the passage of FIRREA, thrifts are now also subject to these same Federal Reserve member bank standards with respect to transactions with affiliates and extensions of credit to insiders. In each of these areas, as in the loans to one borrower provision, FIRREA expands the coverage of a preexisting statute to apply to savings associations in the same manner and to the same extent as if the savings association were, in this case, a member bank. The Federal Reserve Board remains the primary authority for promulgating rules and interpreting these statutes. The OTS,

however, has been charged with enforcing these statutes for thrifts.

Similarly, Congress previously designated the OCC to issue regulations interpreting the national bank lending limit statute, 12 U.S.C. 84. Under FIRREA, this statute will now apply to both banks and thrifts, and the OCC remains the primary authority for interpreting this statute. However, the special provisions for thrifts in section 301 of FIRREA are not a part of 12 U.S.C. 84 and, therefore, the OCC has no rulemaking authority with respect to these provisions. It is expected that the OTS will draw on its own expertise in applying these special provisions to thrifts.

The lead agency concept for statutes enforced by multiple agencies has worked well in the context of other statutes, and we believe that it will work as well for the lending limit statute. We understand that there has been some initial confusion within the thrift industry as to where to turn for guidance for the meaning of the new lending limit. We have received numerous calls from thrifts and from OTS staff with questions about the national bank lending limit. We have provided general guidance to thrifts who have called about the national bank limit. At the same time, we have recommended that thrifts consult with OTS, their regulator, and have reminded callers that OTS has the authority to impose more stringent requirements upon the institutions it regulates.

We are assisting the OTS and the thrift industry to become more familiar with the application of 12 U.S.C. 84 to national banks and our interpretations. Staff members of the OCC and OTS meet frequently to discuss lending limit issues and consult with each other on a regular basis, both in Washington, D.C., and in our respective district offices. To assist the OTS in enforcing compliance with the new lending limit provisions, the OCC has provided the OTS with a copy of its entire file of letters containing legal interpretations of the national bank lending limit.

Based upon our experience, we believe that the lead agency structure works well, and we also believe that it is the best way to avoid confusion and inconsistent interpretations that could be exploited by errant institutions in both the banking and thrift industries.

## Ability of OCC to Provide Regulatory Relief for Thrifts

Since FIRREA was enacted last August, representatives of the thrift industry have urged the OCC to promulgate a transition rule delaying the application of the national bank lending limit to thrifts. We have not been able to provide this relief because we do not believe that the OCC has the authority to delay the effective date of the provisions of section 301 of FIRREA that amend HOLA to impose the national bank lending limit on thrifts. First, the FIRREA provisions amend HOLA, the OCC has no authority to administer the provisions of that statute. Second, we do not believe that an agency may unilaterally delay the effective date of a statutory provision, and we have not found support in the legislation or in the legislative history of FIRREA indicating that Congress intended to delay the effective date of the loans to one borrower section. This lack of evidence indicating Congress's intent stands in marked contrast to other sections of the legislation where Congress did mandate transition periods. For example, section 304 of FIRREA contains a transition rule for certain transactions with affiliates. Based on such factors, we are unable to conclude that the effective date of FIRREA's section 301 amendment of HOLA may be delayed by OCC regulatory action.

It has also been suggested that the OCC alter its definition of capital for lending limit purposes to permit thrift institutions to phase out supervisory goodwill in the calculation of unimpaired capital and surplus. However, such a modification of the existing definition of capital would appear to conflict with the intent of Congress to make the national bank lending limit immediately applicable to thrifts in the same manner and to the same extent as it applies to national banks. Very few national banks have supervisory goodwill. Therefore, a change permitting its inclusion in the calculation of capital for lending limit purposes would effectively result in a different rule for thrifts than for banks. FIRREA did not amend the National Bank Act to give the OCC authority to regulate the thrift industry directly, rather it amended HOLA to provide that national bank standards shall apply to thrifts. Therefore, the regulatory amendment of the definition of capital, in this manner, could be viewed as extending beyond the scope of the OCC's authority to supervise the national banking system.

Thrift industry representatives also have encouraged the OCC to publish additional exceptions to the lending limit. In particular, they have proposed rules of general application directed mainly at permitting thrifts to expand lending capacity in certain areas, such as allowing a higher lending limit for a limited period of time for certain loans collateralized by real estate.

The OCC has the authority "to establish limits or requirements other than those specified" in 12 U.S.C. 84 "for particular classes or categories of loans." In the past, we have adopted rules for certain classes of loans in very limited instances, in response to prudential concerns in the national banking industry. However, at this time, it is unclear that a rule allowing a higher

lending limit for a limited period of time or for certain types of loans would promote safety and soundness

## Conclusion

In FIRREA Congress expressed its intent to subject thrifts to the national bank lending limit statute in the same manner and to the same extent as it applies to national banks. This action has resulted in a significant change in the lending limit under which thrift institutions operate. Adjusting to these changes may be causing some problems for thrift industry borrowers. Dislocations in lending relationships may be particularly severe because thrift industry experience with participations (techniques national banks have used to deal with lending limitations) apparently has been limited. Also, it is often difficult to find other financial institutions willing to purchase participations in partially completed construction projects. However, such problems do not mean that the Congress was wrong in applying the national bank limit to thrifts or that the standards need to be changed. A period of adjustment should be expected.

# Statement of Robert B. Serino, Deputy Chief Counsel (Policy), before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House Committee on Banking, Finance and Urban Affairs, on the Bank Secrecy Act, Washington, D.C., March 8, 1990

Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify today about the Office of the Comptroller of the Currency's ongoing Bank Secrecy Act (BSA) activities and our efforts to combat the serious problem of money laundering. We welcome your interest in these matters. Thank you also for the opportunity to comment on proposed legislation related to money laundering.

The OCC has been and continues to be committed to fighting the war on drugs and, in particular, the money laundering problem. The OCC has always shared the subcommittee's belief in the importance of financial institutions' compliance with the BSA and in preventing such institutions from being used wittingly or unwittingly in laundering money. We have not and will not countenance financial institutions being used to aid in money laundering

We firmly believe that no one should be allowed to launder the proceeds of their illegal activities through financial institutions in this country or abroad. We are extremely sensitive to the adverse impact money laundering has on both the integrity and safety and soundness of the nation's financial institutions. Toward this end the OCC has identified money laundering as a potential systemic risk for the banking industry and has so notified our examiners We remain totally committed to working with the law enforcement community to ensure compliance with all laws, including the BSA and money laundering statutes, and to assist in the investigation and prosecution of organizations or individuals who violate the law

## Industry Communication

The OCC believes that the primary responsibility for ensuring compliance with the law rests with a bank's management and its board of directors. To assist them in meeting this responsibility, the OCC devotes significant resources to educating the banking industry about its responsibilities under the BSA. These efforts include: providing speakers to address industry groups and participate in seminars and training sessions on BSA matters; making BSA specialists and attorneys available to respond to inquiries relating to BSA matters; providing guidance on the BSA and communicating changes to the law and regulations. Our BSA specialists and attorneys across the country and in Washington respond to inquiries on a regular basis concerning BSA and money laundering matters.

In an effort to improve the industry's understanding of money laundering issues, the OCC recently published *Money Laundering: A Banker's Guide to Avoiding Problems*. This booklet presents basic background information on money laundering laws, describes a variety of money laundering schemes that have involved banks, and presents some warning signs that may help bankers avoid getting involved with launderers. The booklet recommends specific steps banks can take to help the government in its anti-laundering efforts. Copies of the booklet were forwarded to all national banks in December 1989, and, to date, more than 70,000 copies have been distributed domestically and internationally Because of the widespread interest

in this publication, the OCC is in the process of printing additional copies for distribution.

## OCC Training

OCC provides formal BSA training to its examining staff on an ongoing basis. Entry-level examiners receive both classroom and on the job training in BSA compliance as part of their training team experience. More experienced examiners attend the Federal Financial Institutions Examination Council's White Collar Crime School, the Joint Bank Regulatory/FBI White Collar Crime School, the OCC's Assistant National Bank Examiner School, and other training programs to sharpen their knowledge of law enforcement issues. The OCC also routinely provides written guidance to all examining personnel detailing any changes to the BSA or money laundering statutes, implementing regulations, or new interpretations of the law.

## Interagency Cooperation

The OCC continues to be an active proponent and participant in interagency coordination in the BSA and money laundering areas. The OCC has been a long-standing active participant in the Bank Secrecy Act Working Group at the Treasury Department. The BSA Working Group has improved communication and enhanced coordination on a variety of BSA related issues. Similarly, the OCC has been a long-standing and active participant in the Justice Department Bank Regulator Bank Fraud Working Group which works to better coordinate the efforts of the law enforcement community and the financial institution regulators. The accomplishments of this group have been well-recognized.

## International Efforts

Recognizing that international cooperation by bankers, regulators, and law enforcement authorities is critical to the success of efforts to combat money laundering, the OCC has also been an active proponent and supporter of international initiatives to address the problem.

The OCC's International Banking and Finance Division (IB&F) assists the Treasury Department as a facilitator in working with developing countries on money laundering issues. Treasury has used IB&F personnel to train bank regulators in developing countries in money laundering examination techniques. OCC representatives have shared their expertise with officials from a number of foreign countries including Australia, Colombia, Canada, Japan, Thailand, Ecuador, and other countries.

The OCC recently met with representatives of the new government of Panama to evaluate its regulatory scheme. The OCC is currently assessing whether and how it can assist by providing additional resources in the form of instructors and training, to assist the government in methods to curtail money laundering.

The OCC representatives on the Basle Committee on Banking Regulation and Supervisory Practices participated in the committee's development of a statement of principles and code of conduct for all financial institutions to follow which was adopted by the committee in December of 1988. Other countries have subsequently endorsed these principles, which are intended to prevent the use of the banking system for money laundering purposes. OCC has issued a notice to all national banks encouraging them to establish policies and procedures to carry out the principles embodied in the international statement, and OCC examiners have been directed to ensure that banks are focusing on the concerns identified in the code.

The OCC has also worked for years as a participating agency of the International Criminal Police Organization (INTERPOL). In particular, we are pleased with our contribution to the Working Group to Improve Cooperation between the Law Enforcement and Banking Communities.

The OCC has also been an active member of the the Financial Action Task Force which was created in July 1989 during the G-7 Summit.

## OCC's BSA Supervisory Efforts

The primary responsibility for compliance with the BSA appropriately rests with each financial institution, since it is the first and most important line of defense against money laundering. At the same time, the OCC has continuing responsibility to monitor the national banking system and to assure that national banks use safe and sound banking practices and comply with the law. Accordingly, in our supervisory efforts, we focus on both management's and the board of director's ability and commitment to ensure behavior that is both prudent and in compliance with the law. It has been our experience that no amount of examination or supervision works as well as a bank's own system of internal controls.

To accomplish OCC's mission of assuring the safety and soundness of the banking system and promoting bank compliance, we have adopted a supervisory philosophy that calls for ongoing supervision of all banks within the system. To supplement our ongoing supervision, the OCC has also instituted a comprehensive compliance program designed to better focus examination resources and, through the deterrent value of random selection, to heighten the indus-

try's own compliance efforts. The program provides for biennial BSA reviews of all banks holding more than $1 billion in assets and annual review of a statistically valid randomly selected sample of other banks.

The flexibility of OCC's supervisory strategy also permits us to target any bank for intensive or repetitive BSA examination or follow-up activity in instances where we have information from any source that suggests a BSA compliance problem. Analyses provided by the U.S. Customs Service, for example, help to pinpoint institutions that exhibit unusual patterns of currency shipments relative to their Currency Transaction Reports (CTR's). Using such leads, we can target compliance efforts to areas where problems are most likely to be uncovered.

## Proposed Legislation

You have asked us to comment on four bills that have been introduced recently to combat money laundering — H.R. 3848, which you introduced, Mr. Chairman; H.R. 4064, introduced by Rep. Esteban Edward Torres; H.R. 3939, introduced by Rep. Jim Saxton; and H.R. 4044, introduced by full committee Chairman Henry B. Gonzalez. The bills under discussion seek to make it easier to detect various types of money laundering and would impose stiff penalties to deter illegal practices. The OCC stands firmly behind congressional efforts to stamp out money laundering, and as I have already mentioned, we have committed extensive resources to deal with the problem. We believe many of the proposals contained in the above bills have merit and would serve the purposes intended. However, others raise concerns, and we welcome the opportunity to share our comments with the subcommittee on both aspects.

### H.R. 3848, Depository Institution Money Laundering Amendments Act of 1990

H.R. 3848 would require the appropriate federal financial institution regulatory agency to revoke the charter of any federal depository institution found guilty of a money laundering or BSA violations. We fully endorse the need for a strong federal response to money laundering in all of its forms, but we have serious reservations regarding the need for the automatic remedy advanced in H.R. 3848. While we agree there may be instances where a bank is so corrupted that its charter should be revoked, we believe that the approach taken in H.R. 3848, which would mandate automatic charter revocation for a bank convicted of a money laundering offense, is unnecessarily broad and could produce unintended results.

The mandatory nature of the charter revocation provided for in H.R. 3848 could raise serious problems for even the most diligent and law abiding bank if the criminal actions of <u>any</u> of its eployees are imputed to the bank itself. Clearly, civil and criminal liability may be imputed to a bank from an individual's actions. A bank's criminal liability and the loss of its charter could be predicated on the activities of a single employee if he is found to be acting within the scope of his employment, even when that employee's conduct is unknown to the highest levels of management.

Automatic charter revocation might also have a chilling effect on bank mergers and the acquisition of failed banks and thrifts if, as one court has recently done, a bank's criminal liability was passed on to its successor. It also might discourage banks from reporting suspicious transactions.

The enforcement remedies currently available to the regulators range from the ultimate powers of termination of insurance, conservatorship and receivership to the intermediate remedies of cease and desist orders, removals, and civil money penalties. Supervision of the banking industry is a judgment business and the regulators exercise that judgment on a daily basis. Based on the facts and circumstances of each case, we determine when and if formal or informal enforcement action should be taken, and also what type.

We believe that we currently possess a number of alternative remedies that can be used very effectively against money laundering. If necessary, some of these remedies could be modified to focus more specifically on money laundering offenses. If this is not deemed feasible, then we suggest that H.R. 3848 be revised in a number of respects.

We would like to suggest alternative approaches to automatic charter revocation that we believe would serve as strong deterrents to money laundering by banks, but that would not penalize innocent parties, including the public.

One alternative would be to enable the Comptroller to place a bank into conservatorship when the bank has been convicted of money laundering and the facts of the conviction justify such a drastic action. Discretion, however, must be given to the regulatory agency to ensure that the punishment fits the crime and that the remedy is determined not solely on the vote of a jury. While conservatorship would permit the regulatory agency to take control of the offending institution, it would not necessitate the revocation of its charter or unduly disrupt its service to the community in which it operates.

Another alternative would be to give the OCC the discretion to recommend termination of insurance for a bank convicted of money laundering.

A final alternative would apply when an individual — bank director, officer, or employee — has been convicted. Since a bank can only operate through individuals, we would support legislation that would provide for an automatic removal of an individual convicted of a money laundering or Bank Secrecy Act offense.

In applying these various remedies, the regulators would be able to evaluate the facts and circumstances on a case by case basis before selecting an appropriate remedial or punitive action. In considering an appropriate response, the regulators would consider such factors as the seriousness of the violation, the history of the bank's compliance with the law, relative degrees of recklessness or willfulness evidenced, the presence of a pattern or practice of money laundering activity, and any failure to establish or maintain relevant policies and procedures to prevent money laundering.

Accordingly, OCC believes that the goal of this legislation could be just as effectively advanced, and the potentially harsh results avoided, through use of the other, more flexible approaches. We believe that these alternatives, coupled with our other remedies, would provide for a very effective response in this area and would also enable the legislation to withstand a constitutional challenge.

### H.R. 4064, International Wire Transfer Recordkeekping Act of 1990

You have also requested our comments on H.R. 4064, the International Wire Transfer Recordkeeping Act of 1990, introduced by Rep. Torres. This proposal seeks to address the problem of money laundering through the international payments systems by wire transfer. H.R. 4064 attempts to trace the flow of funds between any domestic and foreign financial institution or agent by mandating that records be kept of the names and addresses of any party involved in the transaction as well as the account numbers of the debited and credited accounts. The OCC supports the need for some regulation in this area if there is a potential benefit for law enforcement.

Congressional concern about the potential for moving illicit proceeds by international wire transfers is clearly legitimate. As you know, sophisticated laundering schemes for illicit proceeds are difficult to detect. Because transactions are often structured to appear to have a legitimate purpose, it is hard to differentiate illicit wire transfers from the vast number of legitimate transactions that move through global financial systems

In 1988, CHIPS processed approximately 34 million international transfers with an aggregate value of $165 trillion. Large-dollar electronic funds transfers are used to transfer over 80 percent of the value of all payments in the United States. Large-dollar funds transfer networks are primarily used by financial institutions and their corporate customers to make very large, time-critical, dollar payments. The average size of these transfers is between $3 million and $5 million.

The Department of Treasury recently invoked its rule-making authority relating to records and reports on foreign financial agency transactions to determine an appropriate remedy to address the use of the wire transfers to aid money laundering. The comment period closed in January on Treasury's Advance Notice of Proposed Rulemaking (ANPR) soliciting comments on seven regulatory options for recordkeeping systems designed to uncover money laundering schemes using wire transfers.

While we have no doubt that recordkeeping is an important component of an effective law enforcement system to curb money laundering, we believe it may be premature at this time to enact legislation, since the benefit of comments to Treasury on the ANPR may be lost. These comments may be helpful in working out some of the practical problems with keeping records of international wire transfers, such as the ability to get reliable information when a foreign bank is involved as sender — particularly in unregulated countries.

### H.R. 3939, Money Laundering Prevention and Payment System Protection Act of 1990

H.R. 3939, introduced by Rep. Saxton, does not affect national banks. We believe that the effect of our efforts to stamp out money laundering through the use of banks has driven the launderers to channel some of their funds through nondepository institutions that are not federally regulated. H.R. 3939 is designed to prevent money laundering by those institutions, that may be operating illegally.

We share the concern of this proposal that action be taken to ensure uniform regulation and supervision of businesses, such as check cashing stores and money transmitters, that can be used for money laundering In addition, civil and criminal penalties for failure to be licensed or establish policies and procedures to ensure compliance with the recordkeeping or reporting requirements of federal law do not seem unduly harsh

H.R. 4044, Money Laundering Reform Act of 1990

H.R. 4044, introduced by the full committee chairman, includes provisions similar to those in the Torres and Saxton bills. We note that the recordkeeping requirements in H.R. 4044 go beyond those in Rep. Torres's bill and cover domestic as well as international wire transfers. Again, we support keeping records of wire transfers if a useful law enforcement purpose is served. Comments from Treasury's ANPR on detecting money laundering by wire transfers should be evaluated to find ways to resolve the practical problems that affect the usefulness of the proposal.

As to the state regulation of nonbank businesses, such as check cashers and currency exchangers, H.R. 4044's provision is similar to Rep. Saxton's bill and expresses the sense of Congress that the states should license and regulate these businesses in an effort to detect money laundering schemes. We agree that money laundering should be attacked wherever it occurs, not just when insured financial institutions are involved.

H.R. 4044 also would allow the Secretary of Treasury to request that a bank collect prior CTRs from any nondepository financial institution engaged in reportable transactions with the bank. One beneficial effect of this proposal is that businesses already aware of the reporting requirements would have added incentive to comply and those unaware would be put on notice of their legal obligation to file CTRs. Also, the bill would give Treasury specific authority to conduct targeted investigations when it has reason to believe that a business is involved in a laundering scheme.

We also do not object in principle to the other requirements in H.R. 4044 that would enhance detection of money laundering, such as requiring the Federal Reserve Board to report surplus cash flows to the Attorney General and Treasury upon request and clarifying that the Secretary keep targeting orders confidential. Periodic reports on the use of CTR information could also be beneficial in determining the effectiveness of this reporting requirement and the need to modify or supplement this tool. It would also identify for the industry and public the benefits reaped from their efforts and burdens. Likewise, the study on bar coding could provide useful information on an additional method of tracking down money launderers.

In summary, there are a multiplicity of ways that have been suggested to attack money laundering. The effectiveness of each approach should be weighed carefully. Although we understand the desire to move quickly, we believe that some additional time is needed to consider many of these innovative approaches. We would be happy to work with the subcommittee to come up with an effective, workable approach to supplement existing tools.

## Conclusion

The OCC is deeply committed to preventing anyone from using financial institutions to launder the proceeds of their illegal activities. The OCC stands ready to work with Congress, our sister regulatory agencies, and the law enforcement community to further the development and implementation of a coordinated and comprehensive response to the threat posed to the integrity of our nation's financial system by these unlawful activities.

# Statement of Robert B. Serino, Deputy Chief Counsel (Policy), before the Commerce, Consumer and Monetary Affairs Subcommittee, House Committee on Government Operations, on violations and misconduct in national banks, Washington, D.C., March 15, 1990

Mr. Chairman and members of the subcommittee, I am pleased to testify today on the efforts of the Office of the Comptroller of the Currency (OCC) to respond to unsafe or unsound practices, violations of law, or other misconduct in national banks.

This subcommittee's concern is timely given the events which have transpired since this subcommittee last held hearings in this area. I am pleased to report to you on OCC's efforts during this intervening period. We have accomplished much during this period, both independently and working with our fellow regulatory agencies and the law enforcement community. Our intolerance for abuse of banks, and our commitment to strengthening defenses against such activities and to responding vigorously to penalize those who commit such abuses remain strong and resolute. Full and effective cooperation with all elements of the law enforcement community is stronger than ever. Many barriers to such cooperation have been eliminated or significantly lessened, and while we have more yet to do in this regard, we have come far.

Responses to the detailed questions you posed in your letter of invitation have been previously submitted. These responses should serve to more specifically illustrate just how much progress we have made and how well the process is working at the OCC.

Today, I would like to address some of the central themes identified by your questions.

## Nature and Extent of Abuse and Misconduct in National Banks

While we share the subcommittee's concern about existing and potential fraud and misconduct affecting national banks, the matter must be viewed in proper perspective. We should not lose sight of the fact that most national banks are free of insider abuse. The vast majority of men and women who serve the nation's banking needs routinely perform their duties in a safe and lawful manner. One of the reasons significant cases of insider abuse or fraud are considered sensational news is that they do not represent the norm in the national banking system. Notwithstanding this fact, let me make clear at the outset that the OCC believes strongly that no level of bank fraud or insider abuse is acceptable. Such fraud and abuse must be vigorously pursued and those who commit it must be punished. Despite our best efforts to combat fraud and insider abuse, however, there has always been and there will no doubt always be a small percentage of those who will seek to take advantage of their positions. Some of these individuals may even manage to escape or delay detection of their activities. Cases involving nominee loans, "kickback" schemes, fictitious loans, or false entries are difficult to detect — particularly if the individual involved is intent on concealment.

Compliance with laws and regulations pertaining to insiders and the bank's systems for ensuring compliance with such laws and regulations are targeted for review in OCC's examinations. The OCC's enforcement policy places strong emphasis on the importance of proceeding formally against instances of insider abuse and serious violations of law or compliance problems. When instances of serious insider abuse do occur, they are answered with the strongest enforcement actions at our disposal.

In addition, we believe that in certain circumstances the deterrent value of exposure makes public disclosure appropriate. Accordingly, on a case by case basis, we often make public the facts of our enforcement actions and, since the passage of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), we are making public all final enforcement orders.

Whenever there is evidence of fraud, whatever the source, the matter is expeditiously referred to the law enforcement community for criminal prosecution while we proceed with our administrative remedies

## Civil and Regulatory Enforcement

The OCC continues to take strong and vigorous administrative action. In our written response to the questions you have raised in your invitation letter, we have detailed a number of examples of how we have used our various enforcement authorities to respond to abusive practices and violations of law. As now enhanced by the provisions in title IX of FIRREA, these authorities will provide us with even more flexibility going forward.

Since last testifying before this subcommittee, our enforcement process has been invoked to respond to a variety of threats and has frequently been used at the same time that we have pursued an appropriate law enforcement response.

Some of our more significant efforts in this area included:

- Revocation of the trust powers of a national bank for abusive investment practices;
- Use of our cease and desist powers, *inter alia*, to respond to abusive practices involving mortgage servicing rights;
- Use of our temporary cease and desist authority to direct reimbursement of improper bonuses;
- Extensive use of our removal and civil money penalty authorities to respond to a variety of abusive practices and violations of law; including fraudulent or nominee loans, loans to fictitious borrowers, lending limit and insider lending violations, and falsification of bank documents. Where appropriate, we also used our suspension powers to remove individuals who posed an immediate threat to an institution; and
- Use of our investigative authority in a variety of instances, including investigation into a series of bank takeovers by individuals whose intent was to divert bank funds to themselves.

In many of these cases, we referred suspected criminal activity to the law enforcement community and worked closely with them in their investigation and prosecution of the individuals involved.

## Criminal Enforcement Efforts

The OCC has had a very good working relationship with the Department of Justice, the local U.S. Attorney offices, and the FBI. This relationship has been greatly enhanced through the operation of the Bank Fraud Working Group (BFWG) and the many local Bank Fraud Working Groups throughout the country. We believe that the Department of Justice, while it could always use additional resources to combat bank fraud, is working very well to focus resources where they find a necessity. While there will always be instances where more could be done, we believe we have established an outstanding working relationship to ensure that resources are sent to where help is needed. In addition, the further increase in manpower for the Department of Justice as the result of the passage of FIRREA should greatly enhance the Department of Justice's ability in this area.

There have been many cases in which we believe the examining and legal side of the OCC have done an excellent job in coordinating matters with the law enforcement authorities. For example, we have detailed examiners to law enforcement agencies as agents of the grand jury and provided other means of support, such as making one of our enforcement attorneys available to the Department of Justice Fraud Section for two years to assist in the investigation and prosecution of a major bank fraud case in the Southwest.

Our close cooperation with law enforcement has reaped tangible results. In our response to your questions, we have highlighted a number of instances of investigations, prosecutions and other follow-up actions that have resulted from our close working relationships. Some of these involved direct referrals by OCC examiners of suspected criminal activity. Others involved instances of law enforcement alerting the OCC to information which would assist us in supervising the banks involved. Still others involved continuing and long-term cooperation and support in instances where referrals blossomed into full-blown prosecutions. Time after time, OCC has dedicated its resources to support law enforcement investigation and prosecution of bank fraud matters. To serve to illustrate this, we have included a case study with our separate response detailing our efforts involving a major bank fraud in the Northeast.

We are pleased to provide these resources, since many of these efforts have led to convictions and significant criminal sentences. We believe the deterrent effect of such convictions to be extremely beneficial in that they send a strong message to those who would abuse financial institutions and let honest bankers know that the regulatory agencies and the law enforcement community are prepared to come down hard on bank fraud.

Each of these instances is representative of our close and continuing cooperation with law enforcement. We have worked hard to improve and foster this cooperation and will continue to do so.

## Operations and Activities of the Bank Fraud Working Group

Our response to your letter of February 23, 1990, traces some of the accomplishments of the Bank Fraud Working Group, which was first organized in December 1984. OCC has been a continued and enthusiastic participant in this group since its inception and is proud of its many accomplishments. This group has successfully built upon its initial points of agreement and continues to function as a central and vital point of coordination between and among its participants. It stands as a model for how government should work together to attack a serious problem.

When we last testified before this subcommittee, we were able to report to you on the group's accomplishments reflected in its October 1986 progress report. Chief among the accomplishments identified in that report were:

- Adoption of a mandatory criminal referral requirement and uniform criminal referral form;
- Establishment of national and local points of contact;
- Creation and implementation of a joint examiner—investigator training course in the bank fraud area to be given three to four times each year in various parts of the country;
- Adoption of a number of legislative initiatives intended to ease communications between the agencies; and
- Development of a significant case tracking system and enhancement of the FBI's Field Office Information Management System (FOIMS).

Since the BFWG's first accomplishment report, the BFWG has continued to work on many of the projects described above and has also undertaken other projects. The BFWG continues to prove itself to be an excellent forum for effective communication between and among the law enforcement community and the bank regulatory agencies. The rapid proliferation of

more than 14 such groups in major metropolitan areas is perhaps the most direct evidence of the benefits to be derived from this kind of goup. During this period, some of the BFWG's more significant accomplishments included:

- Development and dissemination of uniform guidelines for compliance with the Bank Bribery Act;

- Development of additional training programs for prosecutors and examiners;

- Use of the group as a forum for establishing better coordination between FDIC/FSLIC fee counsel and law enforcement in bank failure cases;

- Use of the BFWG to serve as a forum for the exchange of information regarding significant fraudulent schemes or particular investigations or prosecutions that cut across jurisdictional lines;

- Use of the BFWG as a conduit to the Economic Crime Council and the U.S. Attorney General's Council on issues of concern to the group, including priorities to be assigned to prosecution of bank fraud cases;

- Use of the BFWG as a forum for development of a number of significant legislative proposals, including proposals to amend the Right to Financial Privacy Act and grand jury secrecy rules, and enhancement of civil and criminal enforcement authorities;

- Use of the BFWG as a conduit for providing direct assistance to law enforcement in individual prosecutions by making agency personnel available;

- Use of the BFWG to review important prosecutions and to provide a focal point for other presentations intended to increase the understanding of the BFWG in a number of key areas;

- Production and widespread distribution of a comprehensive Bank Fraud Directory;

- Use of the BFWG to discuss implementation and coordination of the various new responsibilities and authorities under FIRREA;

- Use of the group to assess and develop a coordinated response to other developments in the law impacting on civil and criminal law enforcement, e.g., the *U.S. v. Halper* decision and

- Production and distribution of a model plea agreement.

We believe that the Bank Fraud Working Group has been a resounding success and has accomplished much during its tenure. Improvements in communication and coordination of activity among the civil and criminal law enforcement agencies represented by this group have been significant indeed. This group stands as an excellent example of how agencies with common interests can pull together to break through barriers to communication that otherwise all too frequently exist in government.

## FIRREA Title IX Implementation

The OCC has taken significant steps to incorporate title IX's strengthened enforcement authority into our supervisory process. We are in the process of developing regulations and revising OCC policy statements, including our internal policies and procedures. We are also providing informal guidance to examiners, bankers, and bank counsel pending the final issuance of the regulations and statements of policy.

On March 5, 1990, we published in the *Federal Register* a temporary rule that became effective immediately and requests comments implementing FIRREA's section 914 requirement that national banks give at least 30 days notice to the OCC before adding any individual to the board of directors or employing any individual as a senior executive officer if the bank has been chartered for less than two years, has undergone a change in control within the preceding two years, is not in compliance with minimum capital requirements, or is otherwise in a troubled condition. We recently used the section 914 authority to turn down an application based, in part, on information which we obtained from the Department of Justice after we made a request for the use of grand jury information pursuant to the authority granted by section 964 of FIRREA. While we were able to obtain and act on this information within the 30 day limit imposed by section 914, we are concerned that the amount of time available to obtain and follow up on such information may not always be sufficient.

We have implemented the requirements of section 913 of FIRREA regarding publication of final enforcement orders by publishing listings of our final enforcement orders on a monthly basis in an OCC publication, *Interpretations*. Copies of the actual orders also are available to the general public upon request

We are particularly pleased that section 905 of FIRREA has now clarified our continuing jurisdiction to bring removal and civil money penalty actions against individuals for offenses committed while they were associated with an institution even though they may have subsequently been separated from the institution or the institution may have failed. To date, we have reinstituted approximately 17 actions against individuals pursuant to section 905 which might not have been initiated without this authority. We believe that it will prove to be an effective and valuable aid in our enforcement efforts.

The OCC continues to work in consultation with the Federal Deposit Insurance Corporation, the Board of Governors of the Fderal Reserve System, the Office of Thrift Supervision, and the National Credit Union Administration to implement some of FIRREA's title IX provisions.

An interagency working group is currently drafting guidelines to implement the civil money penalty provisions to reflect the increased assessment authority contained in section 907 of FIRREA. That group is revising the existing guidelines issued by the Federal Financial Institutions Examination Council, which set forth the standards that are used to assess civil money penalties. We are also revising our internal policies and procedures to reflect the increased authority to assess civil money penalties for late call reports contained in section 911 of FIRREA.

Another interagency working group is examining the feasibility of delegating additional enforcement authority to regional or district offices as required by section 917 of FIRREA.

To establish the pool of administrative law judges required by section 916, an interagency working group is conducting research and gathering information, such as statistics on the number of administrative hearings held by the agencies to determine the number of judges needed. In addition, the agencies soon will begin a joint revision of our rules of practice and procedure to make them more consistent and uniform.

The annual report to Congress concerning enforcement actions taken by the OCC, as required by section 918, will be submitted to Congress at the end of the year. We are now in the process of compiling statistics in the format required by FIRREA on actions that have been taken to date. At that time, we will also make any recommendations we may have for additional legislative initiatives that we believe are necessary.

## Implementation of Employee Compensation Provisions

Title XII of FIRREA directs the Comptroller of the Currency to set pay and benefits of OCC staff at levels comparable to those of the other federal bank supervisory agencies. The OCC took its first step to implement this provision on August 13, 1989. These initial adjustments are meant to target those groups of OCC employees with the most obvious pay gaps relative to other financial institution supervisors. As part of the interim adjustments, all employees assigned to positions in certain high cost cities now receive a percentage-based supplement to base pay. As a result, approximately 1,800 of the 3,250 OCC employees currently receive geographic pay differentials. These employees are located in high cost of living cities in which the OCC has problems retaining experienced staff. Also, upper level management and 1,100 trainee-level employees received across-the-board pay increases to make their salaries more comparable to the other federal bank supervisors.

To further implement the compensation provisions of FIRREA, the OCC has retained a compensation consultant to assist us in ensuring that the OCC compensation program is comparable to those of other financial regulators. We expect to have recommendations from the consultant this summer and to implement any additional changes to our pay structure thereafter.

## Real Estate Lending Issues

The OCC has taken a number of steps in response to the growth in real estate loans by national banks and the rise in the percentage of those loans that are nonperforming. Our examiners have specifically targeted the real estate lending practices of national banks in regions where there is evidence of softening real estate markets or unsound lending practices. We have also issued advisory notices to all national banks highlighting our concerns about increased real estate credit exposure.

To help examiners target the most serious problems, the OCC recently developed a real estate valuation model which simulates the effect of a downturn in real estate markets on bank equity capital. The model will be used to identify potentially vulnerable banks and to prioritize such institutions for more in depth review. Results generated by the model will not be used, however, as a basis alone for downgrading any particular bank without additional specific review of that bank. The OCC is working with other bank supervisory agencies to ensure the sharing of relevant data on bank real estate holdings and underlying market conditions.

In 1989 and continuing into this year, the OCC conducted targeted examinations of banks with large real estate portfolios in the softening New England market. On a priority basis, "streamlined" real estate examinations will be conducted at selected New England regional banks to identify credit administration weaknesses and determine the need for full scope asset quality examinations.

Going forward, we will continue to monitor trends in real estate markets and bank exposure to real estate loans. We are paying particular attention to some commercial real estate markets in areas of the country that have experienced sharp increases in their vacancy rates. Although weaknesses in those markets do not appear at this time to be as severe as they have been in the southwest, many national banks have significant commercial real estate loan exposures, and some have experienced rising levels of nonperforming real estate loans and real estate loan charge offs

## Conclusion

As we have indicated, OCC has already done much to implement the various provisions of FIRREA. Congress has given us the additional tools we need to meet the challenge of effective bank supervision going forward and we will use them vigorously. Many of these will enhance our ability to respond to fraud and abuse whenever we encounter it. Let me conclude by repeating that the OCC will not countenance wrongdoing in the national banking system and will continue to use the full range of its enforcement powers to respond to it. We look forward to continuing to work with our fellow agencies and the Justice Department to do all that we can in this effort.

# Remarks by Karen J. Wilson, Deputy Comptroller, Northeastern District Office, before the Banking and Financial Analysts Association 20th Annual Banking Symposium, on supervision of real estate lending, New York, New York, March 21, 1990

Several years ago, I received the most glamorous and sought-after assignment the OCC offers its examiners, a rotation through our London office, which is located in the American Embassy there. A few months later, a good friend of mine from the Deep South, a very devout fundamentalist Protestant, came over to visit me. This woman was very religious, so religious, in fact, that the one thing she most wanted to do in London was to go to services at St. Paul's Cathedral.

I was happy to oblige her as soon as the first Sunday rolled around. It was everything she imagined it to be and more. She had never seen or heard anything so beautiful. The organ pealed, the choirs sang, and the whole thing was wonderful to her. She got so excited she jumped up and shouted: "Glory hallelujah!"

An usher in a cutaway coat came quickly down the aisle and said: "Madam, we don't allow outbursts here!" And she said: "I can't help it. I've got religion." The usher drew himself up and said stiffly: "That is obviously the case, but, Madam, you didn't get it here."

Recently, people in the financial community — including analysts — have come to believe that the OCC is out to write down and even write off all real estate holdings of national banks in New England. Some take it so far as writing down and writing off the entire Northeast. In turn, analysts are making a similar blanket judgment about the financial condition of national banks in New England and in the Northeast, rather than differentiating among individual institutions there.

I don't know where these beliefs come from, but speaking for the OCC, I can say that these beliefs did not come from here.

In the Northeast and in New England, we find the financial condition of institutions so varied that we rank them across the range of our safety and soundness rating system. Some have problems. Some have severe problems. Some have far fewer problems of far less severity. And some are adequate, which in the language of bank supervision is the highest ranking a bank can attain. You see, we're not given to praise. That is not our job.

Rather, part of our job is to examine institutions — individually, that is to say, case by case — to determine each individual institution's financial health and managerial strength. That being the case, we have found institutions that have weaknesses in their real estate portfolios and in their managerial systems. And it should come as no surprise to any of you that there is a

correlation between weaknesses in the portfolio and weaknesses in management

But these are after the fact, after the examination of the particular institution, determinations

True, two years ago Comptroller Clarke stated his concern, based on economic analysis, that the real estate market in the East was softening and that bankers should proceed with care. And we've found weaknesses — in real estate, in portfolios, in management — not just in the East. When I headed our Central District headquartered in Chicago, we found softening in the real estate market there more than a year ago. Given all of this history, I can understand that the erroneous beliefs that many people have taken on faith do, in fact, have a basis in our actions. But these beliefs are a misinterpretation of what our job is and what we are about.

Advising bankers to take care, and to take action that would allow them to determine the state of their investments, is also part of our job. We saw the real estate market begin to deteriorate. We advised bankers to proceed with caution in an effort to prevent future problems from arising. And we have targeted real estate for supervisory review and, when warranted, supervisory action.

But in doing so, we haven't changed our standards. Rather, we're simply applying our old standards to a changed environment. We are responding to problems that exist and that require a response. True, three years ago and more, real estate was just one factor in our systemic approach to supervision. Now it is the number one issue in our systemic approach. But the increased emphasis resulted from our findings in monitoring and examining institutions, where we found that, owing to heavy competition in a hot market, national banks had liberalized lending standards.

We also found that, in their search for growth, national banks had slacked off on proper credit administration. We found that the management of national banks had put too heavy a work load on individual credit officers. We also found that, when the market had declined, national banks had not gotten new appraisals. We found that, even when they had gotten new appraisals, they had not given them the hard look the new appraisals deserved in a negative environment.

To a bank supervisor, all of these actions and inactions are, if you will, sins of commission and sins of omission: We found that banks did things they shouldn't have done and avoided doing things that they should have.

But we are not holding banks up to a new list of commandments. Rather, we have weighed the financial condition and management of banks on a scale known to all who take an interest in these things, which again is our job, and found they are wanting in some cases

In saying that, however, I want to stress that I am in no way undermining the simple fact that, given our experience of the last five years, we now have greater expertise in the area of real estate lending than we had at any time in the past.

In the course of doing our job, we have come under criticism for creating a credit crunch in real estate finance, and, thus, turning off an engine, perhaps the major engine, of economic growth in some local economies.

But let's look at some hard realities. Some of these markets have urban office space vacancy rates of 20 and even 30 percent. In common parlance, they are overbuilt. Given that some of these loans are already nonperforming, is it any wonder that banks are not taking on significant new risks in these markets?

For the sake of argument, let's assume that they continue to take on significant risk. The excesses that have already occurred will continue to grow, thus assuring an even bigger fall later.

Arguing that bank credit must continue to finance projects that have no realistic prospects of being economically viable in the foreseeable future just to prop up continued economic growth is like arguing that the government should have subsidized the horse-drawn wagon and carriage businesses in New York City after the invention of the internal combustion engine to assure the livelihood of teamsters and blacksmiths.

You might achieve the short term goal. But you would do so at the costs of assuring a great deal of inefficiency in the economy — that is to say, nonproductive resources — as well as assuring a large mess somebody would have to clean up. The longer you waited to clean up the mess, the larger it would be. At best, that mess would be unsightly. At worst it would become a menace to the public.

We want to assure a strong and stable national banking system that provides a foundation for a strong and stable economy. It doesn't take a doctorate in economics from Columbia to figure out that you cannot build a strong and stable bank by it lending to projects that are not viable given the market.

Along with avoiding making a blanket judgment about the Northeast, there is something else that analysts should do that many are not doing now. Push banks to give you better information on loan portfolio quality

Bankers respect your power to determine the future course of their institutions. Use your leverage.

In conclusion, I want to share with you the fundamental premise we at the OCC share. Once you know it, most of the mystery around what we do and why we do it will disappear. The premise is simply that "there are a limitless number of ways to do a thing wrong and a limited number of ways to do a thing right."

# Interpretations—January 1 to March 31, 1990

Subject

## Interpretive Letters*

### 494 — December 20, 1989

This letter responds to the notification by Security Pacific National Bank ("Bank") to the Office of the Comptroller of the Currency ("OCC") of the Bank's intent to perform new activities in its operating subsidiary, Security Pacific Futures, Inc. ("Subsidiary"). The Subsidiary currently buys and sells financial futures and options, as agent for its customers, and provides related execution and advisory services. The proposed new activities include purchasing and selling financial futures and options for its own account and providing clearing services in connection with transactions in financial futures and options. The Bank also proposes that the Subsidiary provide similar execution, clearing, and advisory services for customer transactions in agricultural, petroleum, and metals futures and options on such futures. The OCC has determined that these activities are permissible for national banks. Accordingly, the Bank may perform these activities in the Subsidiary.

#### I. The Bank's Proposal

At the present time, the Subsidiary, as agent for its customers, purchases and sells, and provides execution and advisory services relating to transactions in, futures contracts in U.S. Government and Agency securities, domestic and Eurodollar money market instruments, bank certificates of deposit, foreign currencies, and gold and silver and related options on such futures (collectively "financial futures and options" or simply "financial futures"). The Subsidiary is registered as a futures commission merchant ("FCM") with the Commodity Futures Trading Commission, and is a non-clearing member of the Chicago Board of Trade.

The Bank proposes to expand the activities of the Subsidiary and has filed the present notification in compliance with 12 CFR 5.34(d)(1)(i). Our understanding of the Bank's proposal is based upon the Bank's notification letter, the legal memorandum provided by Bank counsel, and conversations between Bank counsel and Richard H. Cleva, an attorney in the OCC's Legal Advisory Services Division.

#### A. Expansion of Activities Involving Financial Futures

The Bank proposes to expand the Subsidiary's activities involving financial futures and options to include purchasing and selling such financial futures for its own account. The financial futures in question all pertain to instruments and commodities which are eligible for banks to trade, deal in, and purchase for their own account (*i.e.*, U.S. and Agency securities, domestic and Eurodollar money market instruments, bank certificates of deposit, foreign currencies, and gold and silver). The Subsidiary intends to purchase and sell financial futures primarily for hedging purposes, to arbitrage certain financial contracts against other financial contracts, and to take advantage of other arbitrage opportunities. Any transactions undertaken for purposes other than hedging and arbitrage will be pursuant to specific policy statements adopted by the Subsidiary's Board of Directors concerning dealer trading activities.

In Banking Circular 79 (3d Rev. April 19, 1983) and in several letters, such as those cited in note 1 below, the OCC has set forth guidelines for national banks purchasing and selling financial futures and options on bank eligible instruments for their own account. The Bank commits that it will conduct these proposed activities in the Subsidiary in compliance with OCC guidelines. In particular, the Bank represents:

(1) Non-hedging uses of financial futures will be undertaken only by dealer units and will be limited to contracts on instruments in which the Bank is authorized to deal.

(2) The Subsidiary's Board of Directors will adopt specific written policies as well as internal control procedures with regard to its trading activities in financial contracts.

(3) The Subsidiary's Board will adopt institutional limits with respect to each type of financial future or option contract. Aggregate bankwide positions in any financial futures or options contract will also be monitored and will be limited to a reasonable percentage of the total "open interest" in a contract month, consistent with safety and soundness considerations.

(4) The Subsidiary will maintain a contract register adequate to identify and control all financial futures and options contracts.

(5) The Subsidiary will account for transactions for its own account by the method required by the OCC. In general, procedural controls, limits, and accounting methods consistent with those discussed in Banking Circular 79 will be established, with appropriate tests to evaluate them on an ongoing basis.

*Note Intepretive Letters and No Objection Letters reflect the views of the Comptroller's legal staff Trust Interpretations reflect the views of the Trust Activities Division.

The Bank also plans to have the Subsidiary join additional exchanges and further proposes that the Subsidiary provide clearing services in connection with transactions in financial futures and options for its own account and for the account of its customers. (The Bank also proposes to have the Subsidiary join exchanges and provide clearing and execution for customer transactions in agricultural futures, as discussed below; the description here of the Bank's proposal regarding exchange membership and clearing also applies to the proposed services regarding agricultural futures.) To provide these services, the Subsidiary would expect to become a clearing member of the Chicago Board of Trade, the Chicago Mercantile Exchange, the New York Mercantile Exchange, the Commodity Exchange, Inc., the Philadelphia Board of Trade, the New York Futures Exchange, Inc., and the Coffee, Sugar & Cocoa Exchange, Inc., and of the clearing associations affiliated with such exchanges.

Both execution and clearance services for various securities, options, and futures contracts are elements of a single process of the purchase or sale of the instrument. Consequently, clearing brokers or FCMs generally provide both clearing and execution services for their customers. The execution and clearance services provided by an FCM are the same, involving the same procedures and risks, regardless of the instrument involved or the type of instrument or commodity underlying the futures contract or related option.

Execution is the initial step in the purchase and sale process. It involves taking the customer's order to the market on which the instrument is bought and sold and finding a counterparty willing to enter into an agreement at the desired price and quantity. Clearing, the second step, involves the settlement of the transaction. Clearance is the process of recording a transaction after execution, and then reporting it to the exchange and the appropriate clearing association for settlement. The clearing function is essentially a credit extension process. After receipt of executed orders from its customers, the clearing broker or FCM supplies its own credit to those orders and transmits them to the exchange clearing organization. Absent execution and clearing capabilities, a broker's services are limited to placing its customer's buy or sell orders with an execution and clearing firm.

In similar contexts involving clearing membership in exchanges and/or acting as market-maker, the OCC on previous occasions, such as the letters cited in note 1 below, has placed certain general limitations on operations for safety and soundness considerations. These limitations primarily concern the relationships between the bank and the subsidiary that would be the exchange member and between the bank and the exchanges. Among the concerns addressed by these limitations are exchange requirements that transactions in "proprietary accounts" be guaranteed by the corporate parent of an exchange member. The term "proprietary accounts" is usually defined to include all transactions executed for the member firm's own account, for affiliates of the exchange member, or for officers and directors of the member firm or its affiliates. Any commitment by a national bank to guarantee transactions in such proprietary accounts at a bank subsidiary or affiliate raises serious concerns because this type of open-ended guarantee introduces unlimited exposure at the bank level and may also raise questions under 12 U.S.C. 371c and 375b which limit bank exposure to nonbank affiliates and insiders. Accordingly, the OCC's limitations prohibit such guarantees by the bank.

In the present proposal, the Bank commits to comply with the conditions the OCC has previously articulated and with any modifications or additional limitations the OCC may place on national banks in these areas in the future. In particular, the Bank commits to adhere to the following conditions:

(1) The Subsidiary will not join any exchange or clearing association that requires the Bank or any other subsidiary of the Bank to guarantee or otherwise become liable for trades executed and/or cleared by the Subsidiary.

(2) Unless well secured as described below, the Bank's direct and indirect investment in, loans and other extensions of credit to, and purchases of assets from the Subsidiary will not exceed in the aggregate an amount equal to 15 percent of the Bank's capital and surplus at the time of the investment or loan of any funds or the purchase of any assets. Any investments, loans and other extensions of credit, or purchases of assets in aggregate amounts exceeding the 15 percent limit must be fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount by which the investment, loan, or purchase of assets exceeds the 15 percent limit; provided, however, that in no case will the Bank's combined secured and unsecured investment in, loans and other extensions of credit to, and purchases of assets from the Subsidiary exceed in the aggregate an amount equal to 25 percent of the Bank's capital and surplus. For the purposes of these limitations, the Bank's investment in the Subsidiary is considered to be unsecured and subject to the basic 15 percent limit

### B. Expansion of Activities Involving Agricultural Futures

The Bank also proposes that the Subsidiary, solely as agent for its customers, purchase and sell, and provide execution, clearing, and advisory services in connection with transactions in, futures contracts and related options on all other financial and non-financial commodities. Initially, the Bank expects the Subsidiary to offer certain agricultural, petroleum, and metals futures contracts, and options on such futures, for which the underlying commodities are soybeans, heating oil, crude oil, gasoline, propane, platinum, palladium, and copper. (Hereafter, the terms "agricultural futures and options" or simply "agricultural futures" will be used to refer to futures contracts and related options on all such agricultural, petroleum, metals, and other non-financial commodities.)

The execution, clearance, and advisory services which the Subsidiary would offer for agricultural futures are essentially the same as those for financial futures, as discussed above regarding execution and clearance or as currently offered with respect to advice. The Bank's representations and commitments regarding the manner in which the Subsidiary will conduct its execution and clearing services apply equally with regard to agricultural futures. The investment advisory services would include financial and market analysis, strategy development, research and discretionary funds' management. If required in connection with its activities, the Subsidiary will register as a commodity trading adviser with the CFTC. The Subsidiary may charge separate fees for its advisory services, which in certain instances may be based on performance.

Since the execution, clearance, and advisory services are essentially the same whether the futures are financial futures or agricultural futures, the only new aspect in this part of the Bank's proposal is the agricultural futures themselves. Futures contracts and related options, whatever the underlying instrument or commodity, are instruments that are bought and sold by investors to hedge investments in the underlying instrument or commodity or by producers and users of a commodity in connection with their business operations, or are traded by investors for the same purpose as securities or other investments are traded, namely, to make cash profits as the value of the instruments fluctuates.

Agricultural futures and their market are distinguished from the actual products, contracts for them, and their market. Agricultural futures are standardized contractual agreements providing for the delivery of a specified amount of a particular product during a specified future month, but they do not involve ownership of, or immediate transfer of ownership of, the product. In the futures market, it is the futures contracts themselves that are bought and sold. Thus agricultural futures are financial instruments relating to, but not identified with, the products. On the other hand actual products are purchased and sold in the cash market (sometimes referred to as the actual market) on a negotiated basis between the owner-seller and the buyer. The agreement or contract may call for immediate delivery or delivery at a later date, *i.e.*, forward delivery. These contracts contemplate transfer of ownership of the products. Futures contracts may be fulfilled either by delivery contracts or offset. However, only a very minimal portion of all futures are ever settled by deliveries. Most contracts are offset or liquidated prior to the delivery month. But in the actual market, delivery is expected. In summary then, futures contracts are standardized separate instruments traded in their own right under recognized procedures on recognized exchanges, while contracts for commodity products (including forward contracts) are business contracts for the sale of goods which contemplate actual delivery, are not standardized, and are not traded on exchanges. *See generally*, Horn & Farah, *Trading in Commodity Futures* 7-8 (2d ed. 1979); 1 Russo, *Regulation of the Commodities Futures and Options Market* 9.01-9.02 (1986).

It is expected that the large marjority of the Subisidary's customers will be financial institutions (including the Bank and its affiliates), other institutions, and large producers and users of the commodities underlying the futures contracts or related options. The Subsidiary's remaining customers are expected to be individuals. The Subsidiary will continue to conduct its activities out of its Chicago, Illinois office, and may open offices in other cities in the future.

## II. Legal Analysis

Most of the activities in the Bank's proposal — namely, trading in financial futures and options for a bank's own account; providing execution, clearance, and investment advisory services generally; and being a clearing member of exchanges — have been previously considered by the OCC and found to be within the legally authorized powers of national banks.[1] The Bank has committed that it will conduct these activities in compliance with OCC supervisory guidelines and condi-

[1] *See, e.g.*, OCC Letter No. 422 (April 11, 1988), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,646 (trading for own account and market-making, clearing, exchange membership); OCC Letter No. 384 (May 19, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,608 (same); OCC Letter No. 372 (November 7, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,542 (same); OCC Letter No. 380 (December 29, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,604 (execution, clearance, exchange membership); OCC Letter No. 365 (August 11, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,535 (advisory services).

tions. Accordingly, we approve the Bank's proposal for the Subsidiary for these activities.

However, one aspect of the Bank's proposal — namely, providing execution and clearance services for customer transactions specifically with respect to agricultural futures and related options — has not been previously decided by the OCC and, indeed, has been expressly reserved for further analysis. *See* OCC Letter No. 380. The question raised by the Bank's proposal is whether the execution and clearance of agricultural futures for customers is within the authorized powers of national banks. To answer this question we first examine the basic statutory authority granted to national banks, then observe how brokerage (execution and clearance) fits into the statutory framework, and finally determine whether brokering agricultural futures is a logical part of banks' brokerage power.

In our view, the purchase and sale of agricultural futures and options for customers is within the powers of national banks under 12 U.S.C. 24 (Seventh). The "business of banking" granted under the statute is a broad concept which includes a wide and flexible range of powers and activities. The power to broker financial instruments, such as agricultural futures and options, is within that range. Such brokerage is a financial activity associated with banks' many other activities with financial instruments, manifesting banks' role as intermediaries in the economy, and related to other financial services offered by banks. Moreover, part of this brokerage service — namely, clearing — is itself a credit extension process. This shows another connection to the business of banking. Finally, such brokerage traditionally has been performed by banks and is a part of customary expectation. In historical practice, national banks' power to broker was widely recognized as a part of their basic banking charter authority. Brokering agricultural futures and options is permissible because these instruments and their market are financial in nature and purpose.

## A. The "Business of Banking"

The National Bank Act provides that national banks shall have the power:

> To exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter.

Act of June 3, 1864, ch. 106, section 8, 13 Stat. 99, 101 (codified as amended at 12 U.S.C. 24 (Seventh)).

This bank powers clause is a broad grant of the power to engage in the business of banking, including the five specifically recited powers and such other incidental powers needed to perform the business of banking. The business of banking is comprised of all those powers which are the recognized incidents or features of that business. The five enumerated powers are examples of banking powers, but they are not the exclusive list. Many other activities are also inherent parts of the business of banking.

Analysis of the statutory language and history surrounding the statute's enactment, as well as case law and critical commentary, all clearly support the interpretation that the act is a broad grant of the "business of banking." As we shall show below, the narrower interpretation — namely, that the act grants only the five specified powers and such ancillary powers needed to perform those five — is not well founded. Moreover, as the agency charged with the administration of the statute, the OCC consistently and traditionally has construed the bank powers clause of section 24 (Seventh) under the broader view and rejected the narrower view as an incorrect statutory construction. *See, e.g.*, OCC Letter No. 377 (February 6, 1987), *reprinted in* Fed. Banking. L. Rep. (CCH) ¶ 85,601; Letter from Peter Liebesman, Assistant Director (August 15, 1983) (unpublished); Letter from C. Westbrook Murphy, Deputy Comptroller for Law and Chief Counsel (September 1, 1976) (unpublished); Letter from James J. Saxon, Comptroller of the Currency (June 13, 1966) (unpublished).

### 1. Statutory analysis and legislative history

The broader view — that the "business of banking" is not confined to the five powers listed after that phrase — is supported initially by the statutory language itself. The "business of banking" phrase is broadly written; if Congress had intended a narrow grant, limited to the five expressly listed powers, it would have been a simple matter to do so.

Moreover, it is a fundamental rule of statutory construction that a reasonable construction which gives effect to all the statute's terms is to be followed rather than a construction which renders part of the statute redundant. *See, e.g., Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307-08 (1961); *Norfolk & Western Railway Co. v. United States*, 768 F.2d 373, 379 (D.C. Cir. 1985), *cert. denied*, 93 L.Ed.2d 247 (1986). *See generally* 2A *Sutherland Statutory Construction* 46.06 (Sands 4th Ed.). If the bank powers clause is limited only to the five listed powers, this renders the term, "the business of

banking," mere surplusage. The statute should then have been written with merely the five listed powers. But if the "business of banking" phrase is given a broader meaning, of which the five listed powers are only examples, then this interpretation makes the phrase an integral element of the statute and gives meaning and effect to all the terms of the statute.

Finally, the narrow interpretation, if consistently maintained, leads to anomalous results. If the grant of bank powers is limited only to the five listed powers, then it could not include a number of powers which are widely recognized as constitutent parts of banking — *e.g.*, borrowing money or issuing letters of credit. But if the "business of banking" phrase is read broadly, then powers such as these can be found within it.

The legislative history of section 24 (Seventh) and of the National Bank Act generally also supports a broad reading of the "business of banking." First, contemporaneous construction of the statutory forebear of the bank powers clause supports the broad reading. Second, the broad reading is more consistent with the general congressional purpose in enacting the National Bank Act.

The bank powers clause of section 24 (Seventh) is patterned after the powers clause of the New York Free Banking Act of 1838. *See, e.g.*, Trimble, *The Implied Power of National Banks to Issue Letters of Credit and Accept Bills*, 58 Yale L.J. 713, 719 (1949) (citing sources) (hereinafter "Trimble"). Prior to the passage of the National Bank Act, the leading case construing the parallel bank powers language in the New York statute had adopted a broad interpretation of the bank powers granted by the statute, *i.e.*, that the business of banking was not limited only to the express powers contained in the statute. *See Curtis v. Leavitt*, 15 N.Y. 9 (1857), *reprinted in* 5 N.Y.S. App. 661 (1889).

The critical issue in *Curtis* was whether a bank had the power to borrow money under the New York banking statute. In analyzing the scope of the business of banking and finding that the power to borrow is within it, the decision in several places relies on the "rules and principles of banking," on examination of what banks in New York currently were doing and of what banks historically have been permitted to do, and upon the nature and customs of banking practice. *See, e.g.*, *Curtis*, 15 N.Y. at 51-59 (Comstock, J.), 158 (Brown, J.), 213-18 (Paige, J.). The essence of the position adopted in *Curtis* might be summarized as follows: whatever society and custom mean by "banking" is granted under the terms of the statute because it grants the business of banking, not merely the specified powers. *See* Trimble, *supra*, at 718-19. *See generally* Symons, *The "Business of Banking" in Historical Perspective*, 51 Geo. Wash. L. Rev. 676, 694-98 (1983) (discussing *Curtis*) (hereinafter "Symons").

The New York statute's grant of corporate power, then was contemporaneously construed as the grant of the business of banking which included powers beyond those expressly listed, as determined by the court's review of community expectation, history, custom, and practice. The fact that the National Bank Act was based on the New York statute and was enacted just six years after this decision by New York's highest court shows that Congress meant that the bank powers clause and the "business of banking" in the National Bank Act should be similarly broadly construed. *See* Trimble, *supra*, at 716-22.

The general circumstances and purpose of the passage of the National Bank Act provide additional support for a broad construction. The system of national banks was developed to accomplish certain goals of the federal government, such as developing a national currency, financing the Civil War, having federal depositories, and fostering a unitary financial and economic system. *See generally* B. Hammond, *Banks and Politics in America from the Revolution to the Civil War*, 724 (1957); P. Studenski & H. Krooss, *Financial History of the United States*, 154-55, 178-79 (1st ed. 1952).

To achieve these purposes, it was essential that prospective organizers be encouraged to charter national banks and that state-chartered banks be induced to convert to national charters. If national banks' powers were limited only to the listed powers, while state banks' powers were broader, fewer banks would choose the national system. Thus it is unlikely that Congress would intend the banking powers of the proposed new national banks to be any less than the powers of state banks. *See* Symons, *supra*, at 699-700.

### 2. Case law

The case law generally has interpreted the powers of national banks in a broad way, not limiting "banking" only to the five listed powers. In reviewing various activities beyond the five listed powers, the Supreme Court has used a variety of measures in determining whether the activity is within the intended scope of the business of banking under section 24 (Seventh). These measures have included:

> (1) whether the activity is similar to the types of activities permitted by the act and not expressly prohibited under the act, *Wyman v. Wallace*, 201 U.S. 230, 243 (1906) (power to borrow money), or is not "so disconnected with the banking business as to make it in violation of section 24

(Seventh)); *Miller v. King*, 223 U.S. 505, 511 (1912) (power to collect judgment on behalf of depositor);

(2) whether the activity is a "generally adopted method" of banks or one in which banks have traditionally engaged. *Colorado National Bank of Denver v. Bedford*, 310 U.S. 41, 48-50 (1940) (power to conduct safe deposit business);[2]

(3) whether the activity in question "has grown out of the business needs of the country," *Merchants' National Bank of Boston v. The State National Bank of Boston*, 77 U.S. 604, 648 (1871) (power to certify checks is such a regular part of banking that it is within bank cashier's routine authority), or would "promote the convenience of [the bank's] business" for itself or for its customers, *Clement National Bank v. Vermont*, 231 U.S. 120, 140 (1913) (paying taxes on behalf of depositors); and

(4) whether the activity is usual and useful to the bank, or is expected of the bank, in performing its functions in the current competitive climate, *Franklin National Bank of Franklin Square v. New York*, 347 U.S. 373, 377 (1954) (power to advertise bank services); *First National Bank of Hartford v. City of Hartford*, 273 U.S. 548, 559-60 (1927) (power to sell and deal in mortgages and other evidences of debt).

Of even greater importance than the variety and flexibility of the tests used in these cases is their shared assumption that there is a general concept of the business of banking, the proper application of which the Court seeks to find in each case. The Supreme Court and other courts do not limit this investigation merely to listing and parsing the five specifically enumerated powers. *See e.g., Dyer v. Broadway Central Bank*, 252 N.Y. 430, 433, 169 N.E. 635, 636 (1930) (need for courts to recognize that banking develops to meet the demands of business); *Bank of California, N.A., v. City of Portland*, 69 P.2d 273, 275-79 (Oregon 1937), *cert. denied*, 302 U.S. 765 (1938) (surveying historical custom and modern practice to determine that safe deposit business is within business of banking, rejecting view that banking is limited to the five enumerated powers).

Finally, scholars and commentators in the secondary literature generally have criticized the narrow view and found the broad view more in keeping with the purpose and intent of the statute and with public policy. While there is disagreement over how broad the scope of the business of banking is, all agree it goes beyond the five listed powers. *See, e.g.*, Beatty, *What are the Legal Limits to the Expansion of National Bank Services*, 86 Banking L.J. 3 (1969); Harfield, *Sermon on Genesis 17:20; Exodus 1:10 (A Proposal for Testing the Propriety of Expanding Bank Services)*, 85 Banking L.J. 565 (1968); Harfield, *The National Bank Act and Foreign Trade Practices*, 61 Harv. L. Rev. 782 (1948); Huck, *What is the Banking Business?*, 21 Bus. Law 537 (1966); Symons, *supra*; Trimble, *supra*; Note, *The Permissibility of Leasing Under the National Bank Act; M&M Leasing Corp. v. Seattle First National Bank*, 91 Harv. L. Rev. 1347 (1978); Note, *Diversification by National Banks*, 21 Stan. L. Rev. 650 (1969).

Historically, then, the more widely held view is that the National Bank Act grants the power to engage in the business of banking which consists of more than only the five specifically listed powers. But in some recent cases it is said that section 24 (Seventh) grants only the five expressly enumerated powers and such incidental powers as are convenient or useful for performing those five powers. Taken literally, the wording of this test seems to follow a narrow view of the bank powers clause. As discussed earlier, the OCC believes such narrow interpretations of section 24 (Seventh) are incorrect, and accordingly, we would reject this recent test as also an incorrect statutory construction.

However, consideration of the cases as a whole shows that they should not be read as adopting the narrow view. The holdings of the cases and the reasoning used are within the historical broad interpretation. It is only the dictum of the abstract formulation of the test, when removed from the context of the cases, which seems to follow the narrow view. In the context of the facts of each case, the courts do not use the narrow reading but continue to adhere to the traditional broad interpretation.

A leading recent case is *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972). In *Arnold Tours* the court invalidated an OCC interpretive ruling which had authorized national banks to perform travel agency services as incidental to the business of banking. The court held that the operation of a full-scale travel agency business was not authorized under 12 U.S.C. 24 (Seventh). The court also stated that the test to determine whether an activity is authorized is whether the activity is one of the five express powers or is

[2] *Accord Independent Bankers Association of America v. Heimann*, 613 F.2d 1164, 1170 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980) (finding that national banks have power to sell credit life insurance because they have traditionally engaged in similar activities). *Cf. Franklin National Bank of Franklin Square v. New York*, 347 U.S. 373, 376-77 (1954) (noting that prior to passage of the Federal Reserve Act, acceptance of savings deposit accounts by national banks had been usual but was not expressly authorized).

convenient or useful in performing one of the express powers. *Arnold Tours*, 472 F.2d at 432.[3] In subsequent years this test has come to be used to represent the narrow interpretation of the bank powers clause.

However, the *Arnold Tours* court, throughout its opinion, uses arguments which belong to the broad view of the bank powers clause, not the narrow view, in order to support its finding that the travel agency business was not within the business of banking. First, both the court of appeals and the district court stated that whether the travel agency business was permissible depended on whether the activity entailed the performance of financial transactions pertaining to money or substitutes therefor, and they both approved of various financially related travel services. *See* 472 F.2d at 430-31, 438; 338 F.Supp. 721, 723 (D. Mass. 1972). Second, the court considered its analysis consistent with the earlier cases (discussed above) which had contained a wide variety of ways of elucidating the meaning of "banking". Finally, the court conducted an extensive analysis of the historical practice of banks in travel-related business and of the degree of contemporaneous involvement of national banks, indicating that the court believed these are relevant factors in determining whether an activity is permissible under the statute. *See* 472 F.2d at 434-35.

In *M&M Leasing*, another principal recent case, the court's reasoning also follows a broad view of the business of banking, despite the abstract formulation of the test. In that case, the court held that personal property leasing was a permissible activity for national banks. The court reiterated the *Arnold Tours* test and concluded that leasing, when the transaction constitutes a loan of money secured by the leased property, is incidental to the loan of money on personal security (an express power). *See* 563 F.2d at 1382.

In its analysis of leasing, the court discusses how financial leasing is similar to lending on personal security, serves the same purpose as lending, is a new way of conducting the old business of lending, and is functionally interchangeable with lending. Leasing is not described either as an express power itself or as "convenient or useful" for the performance of lending. While the court's analysis does establish a relation with the express lending power, it is a relationship of similarity to lending, not of subordinate convenience in performing lending. But, similarity in function or purpose and "new ways of conducting the very old business of banking" are styles of analysis that belong within the traditional broad interpretation of section 24 (Seventh), not a narrow one.

Moreover, the *M&M Leasing* court itself did not reject broader tests. It used the *Arnold Tours* formulation; and since it found the activity permissible under that formulation, it did not need to consider further broader formulations. Indeed, the court seems to have drawn some comfort in its analysis from the fact that many contend the bank powers clause should be construed broadly. *See* 563 F.2d at 1382.

Finally, in the most recent case construing the bank powers clause, both the court of appeals and the district court strongly criticized the narrow interpretation of the clause and rejected an approach that would look only to the five specified powers. *See American Insurance Association*, 865 F.2d at 281, and 656 F. Supp. at 408 (*AMBAC*). The activity in question in that case was offering municipal bond insurance. Both courts found this activity to be authorized under section 24 (Seventh) on the basis that it is functionally equivalent to a recognized bank activity since municipal bond insurance, like standby letters of credit, is a credit extension process. *Id.*

In summary, the recent cases have not endorsed the narrow view of the business of banking. Examination of the opinions shows that, in application, the courts place their analysis directly in the historical line of broader interpretations of the bank powers clause. Commentators too have pointed out that the literal *Arnold Tours* test does not capture the actual analysis employed by the courts. *See, e.g.*, Symons, *supra*, at 713-14 (*Arnold Tours*); Note, *supra*, 91 Harv. L. Rev. at 1350-51 (*M&M Leasing*).

The recent cases use the same types of arguments that have always been used to determine if an activity is part of the business of banking. If the activity is similar to an express power, relates to an express power, is or is like something banks have traditionally done, or is found to be a financial activity, it is permissible (*M&M Leasing*, *AMBAC*). But if the activity is not closely related to an express power, is not like what banks have heretofore done, and has not been shown to have a sufficient nexus to financial activity in the court's view, then it is found impermissible (*Arnold Tours*). Indeed, the pattern of development in the cases from *Arnold Tours* to

[3]Later cases have reiterated this *Arnold Tours* formula in the course of examining the bank activity in question in each case. *See M&M Leasing Corporation v. Seattle First National Bank*, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978); *American Insurance Association v. Clarke*, 656 F. Supp. 404 (D.D.C. 1987), *aff'd*, 865 F.2d 278 (D.C. Cir. 1988) ("*AMBAC*"); *Guaranty Mortgage Company v. Z.I.D. Associates, Inc.*, 506 F. Supp. 101 (S.D.N.Y. 1980); *National Retailers Corporation of Arizona v. Valley National Bank*, 411 F. Supp. 308 (D. Ariz. 1976), *aff'd per curiam*, 604 F.2d 32 (9th Cir. 1979). These later cases have simply restated the formula without an independent consideration and analysis of the statutory interpretation of the banking clause.

*M&M Leasing* and *AMBAC* has shown the courts making more explicit their underlying adherence to the broader, more flexible understanding of the business of banking.

Accordingly, in view of the strong analytical and historical reasons supporting a broader interpretation and our belief that the recent cases have not in fact departed from it, the OCC reiterates its understanding that section 24 (Seventh) is properly construed as the grant of the power to engage in the business of banking and that the determination of what is included within that business is based on a wide range of factors, not reducible only to the five specifically listed activities. Courts, commentators, and the OCC look to various sources to assist in determining what the features of the business of banking are. These sources include: the financial nature of the activity, similarity to listed powers, usefulness in carrying out listed powers, customary practices of banks, expectations of the community, governmental purposes, and the convenience and needs of society's financial functioning.

B. The "Business of Banking" Includes Execution and Clearance of Financial Instruments for Customers

Applying these various factors for determining what is within the business of banking, the OCC believes that the business of banking includes the execution and clearance of transactions in financial instruments, such as securities, options, and futures contracts, for customers. The provision of such execution and clearance services for customers (hereafter "brokerage") is an attribute of the business of banking.

1. The inherent financial nature of such brokerage activity

Providing brokerage services for financial instruments is within the business of banking as contemplated in section 24 (Seventh) because of the financial nature of the activity and the relationship of this activity to other traditional banking functions. National banks possess various express or implied powers to invest in, trade, deal in, underwrite, and otherwise act in various capacities with a wide variety of financial, investment, and monetary instruments and other financial commodities (such as exchange, coin, and bullion). Banks are regular, active participants int he financial trading markets and normally will have trading expertise. It is a natural part of the same trading process for banks to serve as broker for their customers in other transactions where the bank could not or does not serve as principal but where the trading activity is essentially similar.

The participation of banks as principal in the financial trading markets is itself an aspect of the primary function of banks as financial intermediaries. The role of a bank is to act as an intermediary, a "dealer" in capital, facilitating the flow of money and credit among different parts of the economy. *See, e.g.*, *Auten v. United States National Bank of New York*, 174 U.S. 125, 142-43 (1899) (citing authorities); OCC No-Objection Letter No. 87-5 (July 20, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 84,034. This role takes many forms: providing payments transmission services, borrowing from savers and relending to users, participating in the capital markets as here, or using and adopting whatever new methods the economy, markets, and technology develop over time. As the recognized intermediaries between other, non-bank participants in the financial markets and the payment systems, banks possess the expertise to effect transactions between parties and to manage their own intermediation position.

For instruments where the bank has the power to act for its own account, it clearly can act for its customers. Banks can also act as broker for customers for other financial instruments, even where the bank does not invest in that type of instrument itself, because the financial needs of the customers being served, the financial nature of the instruments themselves, and the brokering activity on the part of the bank are the same, and because the various financial markets are interlinked. Moreover, the banks' ability to function in those markets where it does not act as a principal is enhanced by being able to act as a broker both in those markets and in other financial markets.

The express recognition of brokerage in the Glass-Steagall Act is an example of this wider expected role of bank brokerage authority. While the Glass-Steagall Act limited national banks' power to deal in those "securities" covered by the act for the bank's own account, it expressly preserved banks' power to broker such securities for customers.[4] *See* U.S.C. 24 (Seventh) (second sentence). *See also Securities Industry Assocition v. Comptroller of the Currency*, 577 F.Supp. 252 (D.D.C. 1983), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir. 1985), *cert. denied*, 474 U.S. 1054 (1986) (brokerage), *rev'd*, 479 U.S. 388 (1987) (branching) ("*Security Pacific*") (national banks); *Securities Industry Association v. Board of Governors of the Federal Reserve*

[4]The OCC does not believe that futures and options generally and particularly futures and options on agricultural, petroleum, and metals commodities, are "securities" within the meaning of the Glass-Steagall Act. *See, e.g.*, OCC Letter No. 260 (June 27, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,424; Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division (February 15, 1983) (unpublished). However, if they were covered securities, then clearly national banks would have the power to broker them for customers under the express language of the Glass-Steagall Act.

*System*, 468 U.S. 207 (1984), *aff'g*, 716 F.2d 92 (2d Cir. 1983) ("*Schwab*") (bank holding companies). This historical development is discussed in section 3 below.

Thus, the authority to broker financial instruments represents an associated aspect of the powers of banks to trade, deal in, and invest in instruments where the bank acts as principal and of the express provision to broker securities in the Glass-Steagall Act. Providing customers with brokerage for other financial instruments is an expected and natural accompaniment to these other recognized activities of banks in the financial markets.

There have been many instances of national banks' financial instrument brokerage authority in recent years. Foremost, of course, is securities brokerage under the express terms of the Glass-Steagall Act. Additional examples of financial instruments which are not securities under the Glass-Steagall Act, but which are permissible for national banks to buy and sell for customers include real estate loans, equity investment interests in real estate, and various types of options and futures contracts. Brokerage of variable rate insurance annuity contracts has also been found permissible for national banks. As these examples separately arose, the discussion focused on the particular instrument and related aspects of the business of banking in each case. However, the shared and unified common characteristic of these cases is that each is an example of banks' exercising their generalized brokerage authority. *See, e.g.*, OCC Letter No. 331 (April 4, 1985), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,501 (variable annuities); OCC Letter No. 271 (September 21, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,435 (real estate loans and equity interests); OCC Letter No. 387 (June 22, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,611 (real estate loans); OCC Letter No. 326 (January 17, 1985), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,496 (options); OCC Letter No. 356 (January 7, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,526 (agricultural and metal futures used for hedging); OCC Letter No. 357 (February 26, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,527 (options on financial instruments and on financial futures); OCC Letter No. 365 (August 1, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,535 (financial futures).

### 2. The clearing aspect of brokerage is a credit function

The clearing aspect of the brokerage of financial instruments shows another connection to the business of banking, another demonstration of the financial nature of the activity, and accordingly another reason supporting the conclusion that brokerage of financial instruments, such as futures and options, is a part of the business of banking. Clearing is a form of extending credit, and extending credit is one of the quintessential purposes of banking institutions.

A clearing agent substitutes its credit for that of its customers. A clearing agent is liable to the exchange clearing corporation for performance on all submitted contracts, and thereby assumes, on behalf of its customers, with respect to the exchange clearing corporation and counterparties, the risk of its customers' default. The clearance function is similar to two other traditional bank credit functions in which the bank adds its credit to, or substitutes its credit for, that of its customer: bankers' acceptances and letters of credit. Like clearing, both of these bank credit functions facilitate customer transactions in which the underlying parties are unwilling to accept the credit risk of each other. The bank provides its own direct credit obligation to the counterparty.

The credit function provided by the Subsidiary in its clearing activity, then, is an accepted national bank power, irrespective of the characterization of the form of the credit. For a principal function of a bank is to extend credit, whatever its form. *See Block v. Pennsylvania Exchange Bank*, 253 N.Y. 227, 230-32, 170 N.E. 900, 901 (1930) (Chief Judge Cardozo). When an activity constitutes a form of extending credit, courts have easily found it to be within the powers of national banks. *See, e.g., M&M Leasing*, 563 F.2d at 1382 (personal property leasing); *AMBAC*, 865 F.2d at 281, and 656 F. Supp. at 408-10 (standby credit supporting customers' bond issues).

### 3. Historical recognition of brokerage as part of banking

Examination of the historical practices of banks also reveals that brokerage of financial instruments for customers was considered a customary part of the business of banking. The Glass-Steagall Act explicitly refers to the authority of national banks to buy and sell securities as agent for customers. But this occurred only in 1933; yet national banks were brokering the financial instruments which came to be securities covered by the Glass-Steagall Act long before passage of the act. The authority for national banks to provide these brokerage services was considered part of the business of banking under the National Bank Act. And, just as brokerage authority for securities specifically is based upon the business of banking power, so also brokerage authority for financial instruments generally is part of the business of banking.

The brokerage authority of national banks (as well as underwriting and dealing authority) under the bank powers clause is evidenced in the history of the years prior to the passage of the Glass-Steagall Act and

predecessor provisions of the 1927 McFadden Act. This development was recognized and well noted in various congressional deliberations and court opinions. It has also been surveyed in numerous historical works.

In the later decades of the nineteenth century and early decades of the twentieth, national banks had come to engage in the business of underwriting, dealing, and brokering securities. This development was based upon the banks' general charter authority to engage in the business of banking and was an expression of their banking authority applied to the then newly developing types of instruments and financing processes. With respect to underwriting, dealing, and purchasing for the bank's own account, this development was also linked with the express power to discount and negotiate notes and other evidences of debt. *See, e.g.*, 1924 Annual Report of the Comptroller of the Currency at 12 (suggesting legislation which was forerunner of McFadden Act investment securities provision and stating that dealing in investment securities was an existing practice in which a great number of national banks engage and had become a recognized service of banks). *See generally* W. Peach, *The Securities Affiliates of National Banks* (1939); F. Redlich, *The Molding of American Banking*, Volume 2, at 389-93 (1951); Perkins, *The Divorce of Commercial and Investment Banking. A History*, 88 Banking L.J. 483 (1971).

In the 1920s concern arose that these bank activities were not regulated or limited by statute, and proposals were made to adopt limits and confer regulatory power on the Comptroller. Eventually, in 1927 the McFadden Act placed quantitative limits on the purchases and sales of investment securities by national banks. And in 1933 the Glass-Steagall Act replaced those limits with the now familiar limits on bank dealing, underwriting, and purchasing for its own account. Of greatest importance is that throughout congressional deliberation on the various proposals it was repeatedly recognized and stated, first, that national banks were already widely engaged in these activities under their existing bank charter powers, and second, that the new limitations of these new proposals were not intended to restrict the brokerage for customers which banks engaged in. *See, e.g.*, H.R. Rep. No. 83, 69th Cong., 1st Sess. 2-4 (1926) (securities trading as "a type of business which national banks are now conducting under their incidental charter powers"); S. Rep. No. 473, 69th Cong., 1st Sess. 7 (1926) (same); S. Rep. No. 77, 73d Cong. 1st Sess. 16 (1933) (phrase in Glass-Steagall Act will permit banks securities brokerage for customers "to the same extent as heretofore").

Courts too have recognized that banks possessed brokerage authority under their general banking powers. *See, e.g.*, *Security Pacific*, 577 F.Supp. at 255 & 93 L.Ed 2d at 774 (discussing bank brokerage activity prior to 1927); *Block v. Pennsylvania Exchange Bank*, 253 N.Y. 227, 232, 170 N.E. 900, 901-02 (1930) (Chief Judge Cardozo) (brokerage by banks so widespread that "it may be the subject of judicial notice").

Thus, prior to the passage of the Glass-Steagall Act, the authority of national banks to underwrite, deal in, purchase, and otherwise trade for their own accounts in what we now know as "securities," as well as in various other instruments, such as coin, foreign exchange, notes, or bills of exchange, had developed and become established as a part of their banking powers. Likewise, the authority to broker for customers was similarly recognized. Of course, the power to broker was broader than the bank's power to act for its own account, since the bank could broker for customers instruments which it could not own for itself, such as stock. *Cf.* H.R. Rep. No. 742, 74th Cong., 1st Sess. 18 (1935) (amendment to Glass-Steagall Act clarifying that banks may broker stocks for customers, while they may not purchase stocks for their own accounts).

The Glass-Steagall Act confirmed and made these powers express and imposed restrictions in this area for those instruments and activities covered by the act, particularly with respect to bank underwriting and dealing activity. Having imposed restrictions on the securities covered by the act, the act expressly preserved bank authority to act as agent in the purchase and sale of such securities.

The Glass-Steagall Act limited and channeled these banking powers with respect to the instruments covered by the act. But the underlying source of authority remains national banks' "business of banking" charter power. For those activities and instruments not covered by the Glass-Steagall Act, that underlying source also remains and continues without the overlay of Glass-Steagall.

With regard to instruments which are not securities covered by the Glass-Steagall Act, the terms of the act, of course, do not apply. Thus, with respect to such instruments, banks are in the same position as they were with respect to covered securities in the years prior to the Glass-Steagall Act. And, just as buying and selling such securities for customers was within national banks' banking powers antecedent to the Glass-Steagall Act, so buying and selling other financial instruments for customers was and is within their banking powers. This power so to act for customers is not limited to transactions or customers who already have another relationship with the bank, just as securities brokerage is not limited merely to accommodating

existing bank customers *See Security Pacific*, 577 F Supp. at 254-56.

In summary, therefore, under the factors which both historically and more recently have guided determinations whether an activity was within the intended scope of section 24 (Seventh), brokerage of financial instruments clearly is a part of the business of banking. It is related to various expressly listed activities, to banks' other trading activities with financial instruments, and to other bank financial services. It incorporates a credit extension function. It is a customary practice of banks which has been historically recognized.

### C. Agricultural Futures and Options are Financial Instruments; therefore, Brokerage of Them is Permissible for National Banks

As presented earlier, agricultural futures and options traded on exchanges are financial instruments, and accordingly national banks have the authority to broker them for customers as part of the business of banking. These instruments have features which are similar to those of other financial instruments which national banks broker for customers. They are standardized and interchangeable obligations traded on exchanges. Customers buy, sell, or trade them, along with other financial instruments, to suit their various financial and investment purposes or strategies. Futures contracts are fulfilled by offset or liquidation, and differences settled in cash; they do not contemplate actual delivery of the physical product. They are liquid, and there is high turnover in the market. There are readily and continously available market quotations for them. Their markets function in a regularized and routinized manner like other financial markets. Their brokering process involves substantially the same procedures as those for other financial instruments.

Because agricultural futures and options are essentially financial instruments, for many customers, there is a substantial degree of interchangeability between them and other financial instruments. Customers generally conduct all futures product brokerage through a single firm. This is largely because, in view of the interchangeability of the various types of financial instruments, it is more convenient and efficient for customers to centralize their trading activities.

Moreover, from the broker's perspective as well, brokerage of agricultural futures is closely linked to the brokerage of other financial instruments. They are financial instruments that share the same essential characteristics. They are traded on the same exchanges and markets and have the same requisite high level of liquidity. The functions, the risks, the knowledge, and the service provided are comparable irrespective of whether the financial instrument being brokered is an agricultural future, some other futures product, or a securities product Limitations on the volume of customer trading and open positions, whether self-imposed by the customer or imposed by the broker, encompass agricultural futures as well as all other financial instruments.

In earlier letters, the OCC considered national banks acting as broker for customers for options and futures on various types of monetary instruments, financial instruments, securities, currencies, deposits, and similar items. *See, e.g.*, OCC Letter No. 380, *supra* (summarizing prior letters); OCC Letter No. 357, *supra*; OCC Letter No. 365, *supra*.[5] Those prior letters dealt with instances where the underlying items were themselves financial instruments for which banks have broad powers. Thus, the analysis focused on the characteristic of relation to the underlying instrument and not upon the options and futures as instruments in themselves. The options and futures were described as "integral adjuncts" of the underlying instruments, and the permissibility of national banks' activity with respect to options and futures was discussed in terms of the connection to their dealing, trading, investment, and brokerage powers with respect to the underlying financial instruments.

Futures and options and other derivative instruments based on underlying financial instruments are indeed integral adjuncts of the underlying, and a national bank's power to act with regard to them frequently may be best understood as an extension of the power to act with regard to the underlying. Since broad powers with respect to the underlying instruments were present in the prior letters, the analysis there had no need to go further.

In the present instance, we prefer not to analyze brokerage of agricultural futures on the same basis because the powers of banks with respect to the underlying commodities and with respect to acting as a principal on these agricultural futures and options have not been previously considered by the OCC and may not be as broad as in the prior cases. *But see* Note 6 *infra*. These more fundamental issues are not raised in the Bank's proposal. By focusing simply and more specifically upon a national bank's power to broker financial instruments, we can resolve the Bank's re-

[5]In two prior instances the OCC also approved operating subisidary proposals in which the subsidiary would broker agricultural or metal futures for customers where the customer was using the futures for hedging purposes in connection with bank loans *See* OCC Letter No 356 (January 7, 1986), *reprinted in* Fed Banking L Rep (CCH) ¶ 85,526, Letter from Judith A Walter, Senior Deputy Comptroller (June 19, 1986) (unpublished) In those instances, we noted only the connection with banks express lending power, and our approval was accordingly limited to customer hedging transactions

quest without the need to address these other issues at this time.

It is not the case that any power with regard to futures and options is permissible only if the bank has the same power with respect to the underlying item. Options and futures are financial instruments in their own right. In addition, the power of banks to purchase and sell various instruments, including futures and options, for their customers is distinct from the power of the bank to invest in the instruments for itself or to play various roles in creating the instruments. Those powers implicate other considerations in the analysis of banks' authority. Banks have the power to broker financial instruments for customers. With respect to brokerage, there is ordinarily no need to look to the character of the instrument. In this regard, the power to broker options and futures for customers is similar to the power to broker even those equity securities which banks may not purchase for their own account.

While refining our analysis regarding brokerage, the OCC does not reject the approach taken in the prior letters in all circumstances. In contexts in which the bank is underwriting, dealing, purchasing for its own account, or otherwise acting as a principal, other aspects of bank powers under section 24 (Seventh) are involved. It may then be appropriate or necessary to do a further consideration of the character of the financial instrument and its permissibility for banks. In those contexts, the relationship to underlying items may be a sign of permissibility in some circumstances. For example, in cases in which the bank proposed to trade in options for itself, the OCC in the past has looked to the derivative connection of the options to the underlying authorized financial instruments. *See, e.g.*, OCC Letter No. 384 (May 19, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,608 (buying and selling for account of bank, and acting as market-maker, for exchange-traded options on Eurodollar time deposits and foreign currency); OCC Letter No. 372 (November 7, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,542 (similar); OCC Letter No. 260 (June 27, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,424 (buying and selling for bank's own account options on bank-eligible fixed-income securities).[6]

The OCC has used a similar approach in analyzing the permissibility of national bank activities with "representational" instruments. Bank activities as principal with instruments which represent a pool of underlying instruments are examined in the light of the underlying instruments. The most common examples include pass-through certificates or collateralized mortgage obligations representing the underlying pool of mortgage loans, CMOs representing an underlying pool of bank-eligible agency mortgage certificates, certificates representing an underlying pool of other types of bank loans, and investment company shares representing the underlying collection of investments. *See, e.g.*, OCC Letter No. 418 (February 17, 1988), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,642 (bank issuing mortgage-related instruments, citing prior letters); OCC Letter No. 388 (June 16, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,612 (issuing and participating in sale of bank's mortgage-related instruments), *decision upheld, Securities Industry Association v. Clarke*, 885 F.2d 1034 (2d Cir. 1989), *petition for cert. filed*, No. 89-748 (filed Nov. 9, 1989); OCC Banking Circular 220 (November 21, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 49,102 (purchase for bank's own account of investment company shares where company portfolio consists wholly of bank eligible assets). *See also* 12 C.F.R. 1.3(g) & 1.120 (underwriting, dealing, and purchasing of "indirect" general obligations).

D. Summary

In summary, the "business of banking" powers clause of section 24 (Seventh) includes the power for national banks to broker financial instruments for their customers. This power grew out of historical banking practices and community expectations. It is a financial activity, a part of banks' broad function as financial intermediaries in the economy and connected with banks' power to trade as principal in many financial instruments. Brokerage is further a part of banking through its clearing component, since clearing is a form of extending credit. Brokerage of financial instruments is related to several of the express powers although not reducible to them; and it has been widely recognized by Congress, courts, and commentators as a part of the business of banking. Since agricultural futures and options, like other options and futures, are financial instruments, traded in the financial markets for financial purposes, national banks are empowered under section 24 (Seventh) to buy and sell them for customers.

III. Conclusion

For the reasons set forth above and based upon our review of the Bank's description of the Subsidiary's

[6]However, such connection may not be required to show bank permissibility in all cases. Thus, given the financial character of the instruments and of the market for agricultural futures and options and the bank's intermediary role, it could be argued that it is within the business of banking to act as a trader and market-maker for exchange traded agricultural futures and options. *Cf.* OCC No-Objection Letter No. 87-5 (July 20, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 84,034 (national bank may act as principal in commodity price index swaps with its customers). A bank's use of futures or options may also be permissible where the use is connected to other banking activities and not itself directly prohibited. For example, a bank might propose using commodity futures to hedge its exposure on an underlying commodity, such as crops or oil, which the bank had obtained in satisfaction of debts previously contracted.

activities and the Bank's legal analysis, we believe the additional activities the Bank proposes to perform in the Subsidiary are all legally permissible for national banks. Accordingly, the OCC hereby notifies the Bank pursuant to 12 CFR 5.34 that it may proceed with its proposal.

The Bank and the Subsidiary will be expected to comply with the laws and regulations applicable to the manner in which these activities are conducted and to comply with any future developments in OCC policy and guidance to national banks in this area. The Bank and the Subsidiary will also be expected to conduct these activities in a prudent manner, consistent with safe and sound banking practice and subject to the supervisory authority of, and condition imposed by, the OCC.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

## 495 — December 22, 1989

Your letter dated June 2, 1989, regarding the intent of * * * ("Bank") to perform certain new activities in an operating subsidiary was forwarded to me for reply. As described in your letter, the operating subisidary, * * * ("Subsidiary"), would act as agent in the sale of credit life and disability insurance in connection with loans and leases made by the Bank. The Bank also proposes that the Subsidiary act as agent in the sale of title insurance in connection with mortgage loans made by the Bank. For the reasons stated below, both of these activities are permissible.

A national bank operating subsidiary may perform any activities permitted to its parent bank. *See* 12 CFR 5.34(d)(2). In the case of credit life and disability insurance, the OCC has long permitted national banks to act as agent in the sale of this insurance product in connection with extensions of credit made by the bank. *See, e.g.*, 12 CFR 2.6; OCC Interpretive Letter No. 283, March 16, 1984, *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,447. This authority has been upheld by a federal court. *IBAA v. Heiman*, 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980). Therefore, it is permissible for the Subsidiary to act as agent in the sale of credit life and disability insurance in connection with the Bank's loans and leases.

The OCC has also found that, as incidental to the business of banking, national banks may act as agent in the sale of title insurance in connection with extensions of credit made by the bank. *See* OCC Interpretive Letter No. 368, July 11, 1986, *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,538. The Subsidiary may therefore act as agent in the sale of title insurance in connection with loans originated by the Bank.

Please note that Intepretive Letter No. 368 was the subject of a lawsuit in Texas which was dismissed on procedural grounds. *American Land Title Association v. Clarke*, No. A87-CA-408 (dismissed August 28, 1989) (W.D. Texas). You should also be aware that based on Interpretive Letter No. 368, the OCC stated in a letter dated June 20, 1989, that a national bank could proceed in establishing two *de novo* operating subsidiaries to sell title insurance as agent. This action is now the subject of a lawsuit. *American Land Title Association and New York State Land Title Association v. Clarke*, 89 Civ. 6939 (S.D.N.Y., filed October 18, 1989).

In conclusion, the Subsidiary may act as agent in the sale of credit life and disability insurance as well as title insurance in connection with loans, leases, and mortgages made by the Bank.

J. Michael Shepherd
Senior Deputy Comptroller for
Corporate and Economic Programs

* * *

## 496 — December 18, 1989

This letter responds to the notice you submitted on behalf of * * * ("Bank"), indicating that the Bank intends to conduct new activities through its existing, wholly owned operating subsidiary, * * * (the "Subsidiary"). For the reasons given below, the proposed activities are permissible and the Bank may proceed with the proposal.

### The Bank's Proposal

The Bank proposes that the Subsidiary act as the sole general partner and commodity pool operator of a financial products limited partnership (the "Partnership"). The Subsidiary will conduct all of the Partnership's day-to-day operations. The Partnership will be a commodity pool, which will trade, invest in and hold foreign currency spot, forward, futures, and option contracts. From time to time, the Partnership also may trade, invest in and hold U.S. government obligations and futures and option contracts thereon, as well as gold and silver and forward, futures and option contracts thereon.

The Partnership's objective will be substantial capital appreciation through trading in a wide variety of financial markets over a defined period (which shall be specified by the Subsidiary prior to the sale of the units and which may be anywhere from three to seven years) (the "Time Horizon"). A guarantee may be provided to assure each limited partner of receiving a minimum of a full return of their per unit purchase price at the end of the Time Horizon.[1]

The Subsidiary will initially capitalize the Partnership at a level of between $500,000 and $1 million, and will raise additional capital through a private placement offering of units of limited partnership interests in the Partnership ("units"). The Subsidiary will hold the minimum one percent general partner's interest in the Partnership required for tax purposes.

The units will be sold by the Bank to not more than 100 customers of the Bank, each of whom is an "accredited investor," as defined in Regulation D promulgated by the SEC. The transactions will be exempt from registration requirements under the Securities Act of 1933 because such transactions will not constitute a public offering within the meaning of section 4(2) of such act. The Partnership will make only one private placement offering of its units.

The Bank will insulate itself from the Partnership and its activities as follows:

(1) The Bank will not obtain an ownership interest or security interest in the Partnership's assets or take such assets as collateral except to the extent collateral is taken by the Bank in connection with the Partnership entering into a foreign exchange margin account agreement with the Bank;

(2) the Bank will not purchase any units;

(3) the Bank will not purchase any units for fiduciary or managed accounts unless specifically directed to do so by a person, unaffiliated with the Bank, holding sole investment power over such accounts;

(4) the Bank will not make any representation as to, and will specifically disclaim any responsibility for, the financial position and future prospects of the Partnership;

(5) the Bank will not make any warranties or representations as to the accuracy or adequacy of the financial information furnished or the results to be obtained from the Partnership's trading activity;

(6) neither the Bank nor the Subsidiary will make any representation as to the anticipated future appreciation and ultimate rate of return on the units, other than what is disclosed in the offering materials and consistent with the disclosure requirements under the anti-fraud provisions of the Securities Act of 1933;

(7) the Bank and its affiliates will limit their total commitment to the Partnership (both direct and indirect) to a partnership contribution not exceeding 5 percent of the Bank's primary capital;

(8) the Bank's credit activities with the limited partners and parties to the instruments purchased and sold by the Bank will be independent of those parties' relationship with the Partnership;

(9) parties to such instruments purchased and sold by the Bank will not be required to establish a banking relationship with the Bank;

(10) the Bank will make credit decisions with respect to any party to such instruments or to any limited partner, independent from the Partnership's activities and pursuant to the Bank's customary lending practices;

(11) the Bank will not extend credit to limited partners to finance the acquisition of units;

(12) the Bank will not extend credit to the Subsidiary; and

(13) the Bank will not extend credit to the Partnership except to the extent that the foreign exchange margin facility might be viewed as an extension of credit.

## The Activities of the Partnership

The proposed activities for the Partnership have been previously approved for national banks. The National Bank Act expressly authorizes national banks to engage in the business of "buying and selling exchange, coin and bullion" and to buy and sell U.S. government obligations for their own account. 12 U.S.C. 24 (Seventh). The express power to buy and sell exchange, coin and bullion encompasses transactions

[1] Any guarantee would be provided by the Partnership using a percentage of its capital to purchase zero coupon United States Treasury bonds that will mature on or immediately prior to the Partnership's scheduled termination date, or by an unaffiliated bank issuing a letter of credit guaranteeing the return of the purchase price at the end of the Time Horizon.

for a bank's own account and for the account of its customers.[2] The express power to buy and sell foreign currency includes foreign currency spot transactions.[3] National banks may buy and sell forward, option and futures contracts for their own account where they are authorized to buy and sell the underlying instruments for their own account.[4] In addition, national banks are authorized to execute transactions in options and futures contracts for customers where the bank can execute transactions in the underlying instrument or product for the account of customers.[5] Because the Bank can execute transactions in foreign currency spot, forward, and option contracts, and gold and silver and forward and option contracts thereon, the Bank may provide such service to customers through the Partnership.

### The Subsidiary's Role as General Partner

The OCC has previously stated that a national bank may conduct its permissible activities by way of an operating subsidiary acting as the sole managing general partner in a limited partnership.[6] The features of the proposed Partnership, while not identical to those in the partnerships reviewed in prior letters,[7] are consistent with the general principles contained in those letters in that: (1) the Bank will limit its liability by adequately capitalizing the Subsidiary and insulating the Bank from the Partnership; (2) the partnership agreement will define and limit the Partnership's activities to those consistent with national bank powers and recognize that the Partnership is subject to the OCC's regulation supervision, and examination, (3) any offering materials will state that the Partnership is subject to applicable federal banking laws and regulations, (4) the Subsidiary, as the sole general partner, will effectively possess veto powers over the activities of the Partnership; and (5) the Bank and its subsidiaries and affiliates will limit their total commitment to the Partnership to no more than 5 percent of the Bank's primary capital

Further, the Subsidiary will be adequately capitalized in light of the activities it is to perform. Indeed, for tax purposes, the Subsidiary, as the general partner in the Partnership, must generally have a net worth equalling at least 10 percent of the Partnership's net assets.

### The Sale of the Partnership Units

The only novel aspect of the Bank's proposal is that the Bank itself will privately place units of a partnership of which its subsidiary is general partner.[8] This private placement activity will not subject the Bank to any additional risk and will not violate the Glass-Steagall Act. Assuming *arguendo* that the units are securities within the meaning of the Glass-Steagall Act, the activities of the Bank do not constitute "dealing in" and "underwriting" prohibited by section 16 of the act.

Courts, as well as the OCC, have ruled that banks' private placement of securities on an agency basis constitutes permissible "selling . . . solely, upon the order . . . of . . . customers" and does not constitute "underwriting" prohibited by section 16 of the Glass-Steagall Act.[9] In privately placing the units, the Bank would act solely as agent for the account of the Partnership. The Bank would not purchase the units for its own account. The units will be privately placed with customers of the Bank who qualify as accredited investors and in a manner such that the placement will be exempt from the registration requirements under the Securities Act of 1933.

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[2] OCC Interpretive Letter No. 380 (December 29, 1986), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604

[3] OCC Interpretive Letter No. 414 (February 11, 1988), *reprinted in* [1988-89 Transfer Binder] Fed Banking L. Rep. (CCH) ¶ 85,638.

[4] OCC Interpretive Letter No. 422 (April 11, 1988), *reprinted in* [1988-89 Transfer Binder] Fed Banking L. Rep. (CCH) ¶ 85,646 (finding arbitrage and market maker operations in interest-rate denominated instruments related to instruments national banks can deal in for their own account to be permissible); OCC Interpretive Letter No 260 (June 27, 1983), *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,424 (authorizing the purchase and sale of option contracts for hedging); Banking Circular No. 58 (Rev. Nov 3, 1981) (dealing or engaging in futures and forward transactions concerning coin and bullion is considered incidental to banking).

[5] *See* Interpretive Letter No 380, *supra* note 2

[6] *See* OCC Interpretive Letter No. 423 (April 11, 1988), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L Rep (CCH) ¶ 85,647 (national bank subsidiary permitted to act as sole general partner in limited partnership pooling mortgage-related assets)

[7] *See* OCC Interpretive Letter No 423 (April 11, 1988), *reprinted in* [1988-89 Transfer Binder] Fed Banking L Rep (CCH) ¶ 85,647, OCC Interpretive Letter No 411 (January 20, 1988), *reprinted in* [1988-89 Transfer Binder] Fed Banking L Rep (CCH) ¶ 85,635, OCC Interpretive Letter No. 346 (July 31, 1985), *reprinted in* [1985-87 Transfer Binder] Fed Banking L Rep (CCH) ¶ 85,516

[8] In Interpretive Letter No 422 *supra* note 4, the partnership units were sold through a public offering by an unaffiliated investment banker

[9] *See Securities Industry Ass'n v Board of Governors of the Federal Reserve System*, 807 F 2d 1052, 1059 (D C Cir 1986), *cert denied* 483 U S 1005 (1987), Intepretive Letter No 329 (March 4 1985) *reprinted in* [1985-87 Transfer Binder] Fed Banking L Rep (CCH) ¶ 85,499, No Objection Letter 87-4 (May 19 1987) *reprinted in* [1988-89 Transfer Binder] Fed Banking L Rep (CCH) ¶ 85 033 (private placement of real estate mortgage investment conduit ("REMIC") certificates) *See also Securities Industry Association v Clarke*, Nos 89-6027 and 89-6029, slip op (2d Cir September 8 1989) (the Glass-Steagall Act does not prohibit activities that are part of the business of banking)

In conclusion, the Bank's proposal merely combines previously approved activities in a new way. You may, therefore, proceed with your proposal.

J. Michael Shepherd
Senior Deputy Comptroller for
Corporate and Economic Programs

* * *

## 497 — December 20, 1989

I am writing in response to your letter of October 23, 1989. You asked whether certain transactions planned by * * * ("the Bank") involving bankers' acceptances would be subject to reserve requirements under Federal Reserve System regulations, and whether they would constitute impermissible guaranties. It is my opinion that such acceptances would be treated as reservable deposits and that they would not be impermissible guaranties.

According to your letter, a holding company unaffiliated with the Bank would sign a non-documentary acceptance credit agreement with the Bank. Under the terms of this agreement, the holding company would create acceptances with maturities of 18 months, which would be accepted and discounted by the Bank at an appropriate rate. Then, the Bank would rediscount them to a wholly owned subsidiary of the holding company. This arrangement would enable the Bank to raise funds, while the subsidiary would benefit by obtaining a bank obligation that would be used as a pledgable asset.

An acceptance begins with a draft, which is merely an order by the drawer to the drawee to make payment at a specified time in the future. No rights are created against the drawee until the drawee has accepted the draft, *i.e.*, agreed to honor the drawer's order at maturity. Once this is done, the draft is known as an acceptance and becomes an unconditional obligation of the drawee. If the drawee is a bank, the instrument is known as a "bankers' acceptance." Acceptances are fully negotiable. H. Harfield, Bank Credits and Acceptances 116 (5th ed. 1974).

As you correctly noted in your letter, the planned acceptances will not be "eligible" acceptances; however, that will not affect their legality. The making of acceptances is an essential part of banking authorized by 12 U.S.C. 24 (Seventh) and national banks are not limited in the character of acceptances that they may make in financing credit transactions. Interpretive Ruling 7.7420, 12 CFR 7.7420. *See also* 12 C.F.R. 250.163 (state member banks are not limited to eligible acceptances).

Eligible acceptances are merely those that meet the criteria set forth in section 13 of the Federal Reserve Act, 12 U.S.C. 372. Federal Reserve Banks and member banks may discount acceptances that meet those criteria. However, this statute was not intended to limit the types of acceptances that member banks (including national banks) could discount, but rather to encourage certain types of transactions. *See generally* H. Harfield, *supra*, at 125-28.

Federal reserve member banks are, of course, required to maintain certain reserves against their deposits. 12 U.S.C. 461. Detailed regulations governing reserves are found in the Federal Reserve Board's Regulation D, 12 CFR Part 204. There, the Board lists at great length various types of accounts and items that it considers to be reservable "deposits," including the following:

> (a)(1) "Deposit" means:
>
> . . .
>
> (vii) any liability of a depository institution on any promissory note, acknowledgement of advance, bankers' acceptance, or similar obligation (written or oral), including mortgage-backed bonds, that is issued or undertaken by a depository institution as a means of obtaining funds . . .

12 CFR 204.2(a)(1)(vii). The paragraph then goes on to list several exceptances to this rule, *i.e.*, instruments that are not considered to be deposits; one of these is eligible acceptances.

Thus, obligations arising from the creation of ineligible acceptances (also known as "finance bills"), as well as the proceeds from the sale of such acceptances, are reservable deposits for purposes of Regulation D. In my opinion, the type of acceptances described in your letter will fall into this category.

As you know, national banks are held to lack the power to issue guaranties, except in certain limited circumstances. *See* Interpretive Ruling 7.7010, 12 CFR 7.7010. Your second question was whether the proposed bankers' acceptances would constitute impermissible guaranties.

When a draft is accepted it becomes, in effect, a promissory note. Like any negotiable instrument, it is an independent contract, and any dispute concerning the rights or obligations of the parties must be resolved

solely according to the terms of the note itself. A guaranty, on the other hand, is a contract that is ancillary to some other contract or relationship, so that a dispute of guaranty can only be resolved by determination of the rights and obligations of parties to the principal contract or relationship. *See* H. Harfield, *supra*, at 163-64.

Another difference between an acceptance and a guaranty lies in who is liable for performance. An acceptor assumes primary liability on the instrument. A guaranty, however, is "an undertaking by one person that another shall perform his contract or fulfill his obligation, or that, if he does not, the guarantor will do it for him." Black's Law Dictionary 833 (4th ed. 1957). In other words, a guarantor has secondary liability. It is therefore my conclusion that a bankers' acceptance is not an impermissible guaranty.

You also asked about the difference between bankers' acceptances and commercial paper. They do have some similarities, since they are both types of promissory notes and are used to raise short term funds. Bankers' acceptances have just been discussed. Commercial paper is generally defined by reference to the exemption from registration requirements provided in section 3(a)(3) of the Securities Act of 1933, 15 U.S.C. 77c(a)(3), which exempts from registration promissory notes that:

- have a maturity of nine months or less;
- are of "prime" quality;
- are offered and sold only in large denominations to institutional investors; and
- are used to finance "current transactions."

One difference between them is that a bankers' acceptance would always have at least two parties liable on the instrument, namely the accepting bank (primary liability) and the maker (secondary liability); if the acceptance is rediscounted, a third party could be added. Commercial paper, unless it is resold, would have only one party (the issuer) liable on it.

Another difference is that commercial paper is a security for purposes of the Glass-Steagall Act, 12 U.S.C. 24 (Seventh), while the office does not consider bankers' acceptances to be Glass-Steagall securities. *Compare Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 137 (1984) *with* Interpretive Letter No. 272, August 4, 1983, *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,436. Unfortunately, time does not permit me to discuss in depth the securities law aspects of bankers' acceptances and commercial paper, and I would recommend that you consult Bank counsel if this is a concern for you.

Christopher C. Manthey
Senior Attorney

* * *

## 498 — December 26, 1989

This letter is written with respect to the notice filed by * * * ("Bank") on August 24, 1989, of its intention to form * * * ("FRM") as an operating subsidiary pursuant to 12 CFR 5.34. The 30 day review period established by section 5.34(d)(1)(ii) for such letters was extended by the Office of the Comptroller of the Currency ("OCC") on September 22, 1989.

The purpose and activities of FRM are described in the Bank's notice in the following manner:

> [The Bank] intends to establish an operating subsidiary for the purposes of collecting debts, and managing and liquidating assets acquired in satisfaction of debts previously contracted by financial institutions ("DPC Property") and bank property owned in whole or in part by [Bank], other financial institutions, or government agencies acting as insurers or receivers for financial institutions. It is contemplated the subsidiary would enter into management contracts to provide debt collection, asset management and liquidation services including accounting, data processing, and legal services.

Letter, p. 1.

In telephone conversations with Ferne F. Rubin, Attorney, Legal Advisory Services Division, I understand that you expressed the specific desire that FRM be permitted to perform for the Bank those responsibilities the Bank agreed to undertake in an interim servicing agreement with the Resolution Trust Corporation ("RTC") on October 13, 1989. This agreement, an incident to the Bank's purchase of certain of the assets and assumption of the deposit liabilities of the former University Federal Savings Association, Houston, Texas, provides generally that the Bank will function as a managing agent for the RTC in administering those assets of the failed savings association that were not acquired by the Bank as part of its purchase and assumption transaction.

At this time, approval is given to those aspects of the Bank's proposal under which FRM will perform debt

collection and asset management services with respect to the Bank's properties. With regard to this part of the Bank's proposal, the OCC has previously concluded that national banks may form operating subsidiaries for the purpose of conducting debt collection activities. Interpretive Letter No. 53 from Roberta Walsh Bowman, Assistant Director, Legal Advisory Services Division (July 27, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) Paragraph 85,128. The OCC has also approved the establishment of operating subsidiaries for the purpose of managing, holding, and disposing of the parent bank's assets, including real estate. Interpretive Letter No. 397 from J. Michael Shepherd, Senior Deputy Comptroller for Corporate and Economic Programs (September 15, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) Paragraph 85,621; Interpretive Letter No. 355 from Michael Patriarca, Deputy Comptroller for Multinational Banking (December 10, 1985), *reprinted in* Fed. Banking L. Rep. (CCH) Paragraph 85,525; Interpretive Letter No. 11 from H. Joe Selby, First Deputy Comptroller for Operations (December 23, 1977), *reprinted in* Fed. Banking L. Rep. (CCH) Paragraph 85,086. Consequently, FRM's performance of the activities outlined in the Bank's proposal with regard to the Bank's own DPC Property is permissible under 12 U.S.C. 24 (Seventh) and 29, provided the applicable OCC regulations and interpretive rulings are complied with in accordance with the precedents cited above.

Furthermore, subject to the condition expressed below, approval is given to the contemplated use of FRM as the Bank's agent in fulfilling those responsibilities the Bank undertook in the above-referenced October 13, 1989, interim servicing agreement with the RTC. The Bank's entrance into this agreement with the RTC was a requisite part of that transaction referred to above that was consummated under section 13(k) of the Federal Deposit Insurance Act under which the Bank purchased certain assets and assumed the deposit liabilities of the former University Federal Savings Association. Since the date of that transaction, it is understood that the Bank has entered into a supplemental agreement with the RTC under which it may commit certain of the RTC's assets to sale. With the assumption of these additional responsibilities, the Bank's capacity under the servicing agreement is considered to be of a fiduciary nature, specifically that of a managing agent. As the Bank has authority to exercise trust powers pursuant to 12 U.S.C. 92a, the provision of debt collection, asset management, and liquidation services to the RTC is permissible in such capacity. In performing these services for the Bank, FRM would be functioning as the Bank's agent. As a principle of law, the Bank — as a fiduciary — may employ agents in the fulfillment of certain responsibilities owed to the RTC. See generally IIA A.W. Scott and W.F. Fratcher, *The Law of Trusts* 171.2 (4th ed. 1987). Accordingly, approval is given to the Bank's employment of FRM as its agent in carrying out those managing agent's responsibilities it has undertaken. This approval is subject to the condition that the Bank obtain the RTC's prior written approval to such proposed utilization of FRM.

With regard to the remaining elements of the Bank's proposal under which FRM would perform debt collection, asset management, and liquidation services for other government agencies and other financial institutions, please be advised that we are continuing to review such elements. Therefore, these activities may not be performed in FRM until we advise you of our determinations made with respect to these additional proposed activities.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

## 499 — February 12, 1990

This responds to your bank's proposal relating to sale of annuity contracts, as described in two letters from the bank's counsel, David B. Miller of Faegre & Benson, and subsequent telephone conversations. You have proposed that your bank ("Bank") enter into an agreement with a marketing company ("Marketing") under which the Bank and its employees would promote and sell Flexible Payment Variable Annuity certificates (the "Certificates") issued by the Integrity Life Insurance Company (the "Company") in exchange for an assignment of Marketing's commission from the Company equal to 4.25 percent of the premiums generated from such sales. Bank employees who sold the Certificates would receive individual commissions of 0.25 percent, which would come out of the Bank's commission. Neither the Bank's nor the employees' percentage interest in premiums would vary with the volume of the Certificates sold.

You also inquired about the permissibility of a percentage leasing arrangement with Marketing under which a Marketing administrator would coordinate all annuity programs in the territory from offices located in the Bank. The Bank would provide office space, supplies, office equipment, and secretarial services, in exchange for rent equal to 0.25 percent of the premiums of all annuities sold by the programs for which the administrator is responsible.

For the reasons given below, we believe that the Bank's proposed activities are permissible under the National Bank Act.

## The Certificates

The Certificates combine elements of variable and fixed annuities. An investor in a variable annuity contract purchases a share in an investment portfolio and then receives payments that vary according to the performance of the portfolio. A purchaser of a fixed annuity contract, in contrast, receives a fixed or minimum level of payments. Both types of contracts may have a life term.

The Certificates provide a tax-deferred investment vehicle with a wide range of investment options. A purchaser of a Certificate may allocate his investment among eight different "investment divisions" (the "Divisions"), which offer a variety of investment policies and risk and growth characteristics. Subject to certain limitations, an investor may from time to time make withdrawals against the current value of his Certificate (the "Certificate Value"), transfer funds among the investment divisions, and invest additional amounts in his Certificate.

Upon a prearranged date selected by the investor, the investor may choose to receive his Certificate value as a lump sum or may choose from several annuity options. The annuity may be for a fixed term, for life, or for a minimum fixed term and thereafter for life. Annuity payments may be fixed in advance or may vary according to the value of the investor's Certificate value.

Seven of the eight Divisions permit investors to purchase interests in a mutual fund (the "Trust"). The Trust is an open-end, diversified management investment company registered under the Investment Company Act of 1940 that offers its shares exclusively to separate accounts of several insurance companies to fund variable annuities. The Trust maintains seven classes of shares corresponding to seven of the investment Divisions. These Investment Divisions are: the Common Stock Fund, the Aggressive Stock Fund, the Balanced Fund, the Bond Fund, the High Yield Fund, the Global Fund, and the Money Market Fund. The value of an investor's share in each of these Investment Divisions depends on the performance of the underlying investment portfolio maintained by the Trust.

The eighth investment division, the "Guaranteed Interest Division," differs from the other divisions in that it offers a fixed level of interest. Funds allocated to the Guaranteed Interest Division become part of the general assets of the Company. The Company guarantees principal and interest on funds allocated to the Guaranteed Investment Division

### 1. Authority, 12 U.S.C. 24(7)

The Certificates are called variable annuities, but the Guaranteed Interest Division option permits an investor to allocate some or all of his investment to what is, in effect, a fixed annuity. Although many state banks sell both types of annuities,[1] the OCC has only provided an opinion on the sale by national banks of variable annuities. *See* Interpretive Letter No. 331, April 4, 1985, *reprinted in* [1985-1987 Transfer Binder] Fed Banking Law Rep. (CCH) ¶ 85,501. That letter stated that variable annuity contracts are securities, functionally resembling shares in a mutual fund, and that banks are authorized, pursuant to 12 U.S.C. 24(7) to buy and sell securities for the account of customers. To the extent that the Certificates are Glass-Steagall securities, they would fall within the securities brokerage authority in 12 U.S.C. 24(7) as well. (The Certificates are registered securities under the Securities Act of 1933,[2] but this is not dispositive of whether they are securities for purposes of the Glass-Steagall Act.) However, since we find that brokerage of fixed annuities is a permissible activity for national banks regardless of whether fixed annuities are Glass-Steagall securities, it is unnecessary at this time to determine the status of the Certificates under the Glass-Steagall Act. Brokerage of fixed annuities is permissible because it is within banks' power to broker financial investment instruments.

As part of their traditional role as financial intermediaries, banks have broad powers to buy and sell financial investment instruments as agent for customers. The Glass-Steagall Act explicitly preserved banks' brokerage power with respect to securities, but this power antedated the Glass-Steagall Act[3] and is not limited to securities. Pursuant to this power, national banks may broker a wide variety of financial investment

[1] *See Annuities Sales by Banks. An Up and Coming Business*, ABA Consumer Banking Digest, Sept./Oct. 1989, at 4-9 (bank annuity sales for 1990 predicted to be $10 billion); *Bank Annuity Sales Expected to Double in 1989*, National Underwriter (Life & Health Financial Services Ed.), January 2, 1989, at 3

[2] Some fixed annuities are exempt from the registration requirements of the Securities Act of 1933 *See* 15 U.S.C. 77c(a)(8) (exempting "any insurance or endowment policy or annuity contract or optionl annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.") This exemption has been construed to apply only to fixed annuities *See SEC v. Variable Life Ins. Co.*, 359 U.S. 65 (1959) To distinguish annuities that qualify for the exemption from those that do not, the SEC has promulgated a "safe harbor" definition, Rule 151 *See* 17 CFR 230.151(a)

instruments. *See* Interpretive Letter No. 494 (December 20, 1989) (agricultural, oil, and metals futures).

Although annuities have historically been a product of insurance companies, they are primarily financial investments. Investors who purchase annuities are not seeking to pool a catastrophic risk such as death, injury, or property damage, but are instead seeking a guaranteed, long-term return on their assets. Most commonly, annuities are marketed as a tax-sheltered means of saving for retirement.[4] The element of mortality risk, which is present in some annuities, derives from the investor's willingness to price a contractual arrangement based on the length of his life in order to increase the return he will receive during his lifetime. This risk is essentially an investment risk, not an insurance risk. *See Helvering v. Le Gierse*, 312 U.S. 531, 542 (1941) ("Any risk that the prepayment [premium] would earn less than the amount paid to respondent as an annuity was an investment risk similar to the risk assumed by a bank; it was not an insurance risk. . . ."); *In Re Howerton*, 21 Bankr. 621, 623 (1982) ("Both life insurance and annuity contracts may take various forms but the heart of the distinction between them is this: life insurance is a promise to pay a sum certain on the death of the insured and an annuity is essentially a form of investment which pays periodically during the life of the annuitant or during a term fixed by contract rather than the occurence of a future contingency."); *Daniel v. Life Ins. Co. of Virginia*, 102 S.W.2d 256, 260 (Tex. Civ. App. 1937) ("[An annuity] is essentially a form of investment, and uniformly held to be such, regardless of the fact that in its usual form payments are contingent upon continuity of the life of the grantee."); 1 J. Appleman, Insurance Law and Practice, 84 (1981) ("annuity contracts must . . . be recognized as investments rather than as insurance"). *See also SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 207-208 (1966) ("In fixing the necessary premium [for a fixed annuity] mortality experience is a subordinate factor and the planning problem is to decide what interest and expense rates may be expected. There is some shifting of risk from policyholder to insurer, but no pooling of risks among policyholders. In other words, the insurer is acting in a role similar to that of a savings institution. . . ."). Thus, although annuities often share with insurance the need for actuarial calculations, they are primarily a vehicle for investment.

That fixed annuities are financial investments is further demonstrated by the close functional resemblance between fixed annuity contracts and other financial investment instruments that banks may sell as agent. First, a fixed annuity is similar to a variable annuity. Both can offer the investor a stream of payments extending over his life, and both may involve actuarial calculations. Fixed annuities differ only in that they offer a reduced level of risk, combining for the risk-averse investor the best aspects of both certificates of deposit and annuities. The only distinction between a fixed and a variable annuity — the reduced level of investment risk for the customer — provides no basis for denying to national banks the power to sell fixed annuities as agent.

Second, fixed annuity contracts resemble debt instruments, in that both involve an obligation to make a stream of payments over time.[5] Annuities differ in form from debts in that an annuitant only has an interest in the stream of payments, whereas a creditor has a right to the total amount owed, though the amount may be payable only in installments.[6] But a creditor, like an annuitant, only has an enforceable interest in the periodic payments due him. Thus, the practical obligations of an annuity issuer are essentially the same as those of a debtor.[7]

Finally, a fixed annuity also functionally resembles a certificate of deposit. A fixed annuity contract for a fixed term resembles a certificate of deposit that pays interest and automatically withdraws principal at a rate calculated to reduce the balance to zero at the end of the annuity term. An annuity with a life term resembles a life interest in a certificate of deposit. The owner of a life interest in a certificate of deposit has the right to receive income from the account for life, after which ownership of the account reverts to the owner of the remainder. *See* R. Cunningham, *The Law of Property* 2.16, 4.11

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[3] *See Securities Industry Association v. Federal Reserve Board*, 468 U.S. 207, 214 (1984) ("Banks long have arranged the purchase and sale of securities as an accommodation to their customers. Congress expressly endorsed this traditional banking service in 1933.")

[4] *See Helping Consumers Shelter Income*, ABA Banking Journal, July 1989, at 16, 21 (discussing investment and tax shelter characteristics of annuities).

[5] Many courts have held that an annuity contract creates a debtor-creditor relationship. *See John Hancock Mut. Life Ins. Co. v. Helvering*, 128 F.2d 745, 751 (D.C. Cir. 1942); *Hughes v. Sun Life Assurance Co. of Canada*, 159 F.2d 110, 113 (7th Cir. 1946); *Chatham v. City Hospital*, 325 F.Supp. 614 (S.D. Ga. 1971); *Moses v. Manufactures Life Ins. Co.*, 298 F.Supp. 321 (E.D. S.C. 1968); *Roth v. Kaptowsky*, 393 Ill. 484, 66 N.E.2d 664, 669 (1946); *Crossman Co. v. Rauch*, 263 N.Y. 264, 188 N.E. 748, 751 (1934).

*See also* Land, Life Insurance Option Settlements: Trusts or Debts, 42 Col. L. Rev. 32, 35-44, 47 (1942) (advocating view that an annuity contract creates a debtor-creditor relationship, but also discussing a few cases that hold that an annuity contract creates a trust).

[6] *See Matter of Young*, 806 F.2d 1303, 1306 (5th Cir. 1987); *Commonwealth v. Beisel*, 338 Pa. 519, 13 A.2d 419 (1940).

[7] Another feature of some fixed annuities that may call the debt analogy into question is the life term, but this is really more a matter of custom and pricing than of legal significance. Nothing prevents a debtor and creditor from contracting to settle a debt by a series of payments lasting for life rather than for a term of years. *See, e.g.*, Note, *Reverse Annuity Mortgages and the Due on Sale Clause*, 32 Stan. L. Rev. 143, 145-151 (1979) (discussing reverse annuity mortgages).

(1984). This is precisely the same right that the owner of a life-term annuity has.[8]

Thus, neither of the two major features of fixed annuities, the fixed return and the life term, distinguish them from other financial investment instruments that banks may buy and sell as agent. The financial marketplace provides many examples of instruments that, like fixed annuities, pay the investor a fixed stream of income over time in return for an initial investment. The life term feature is present in some variable annuities, and a life interest in any instrument with a fixed return is, in effect, a fixed annuity. Therefore, fixed annuity contracts are financial investment instruments that national banks have authority to sell as agent.

## Insurance, 12 U.S.C. 92

Although brokerage of fixed annuities is within the business of banking under 12 U.S.C. 24(7), it is also necessary to consider the relationship between 12 U.S.C. 24(7) and 12 U.S.C. 92, which permits national banks in towns with 5,000 or fewer people to act as agent for fire, life or other general insurance companies. Conflicting judicial interpretations of section 92 have complicated this relationship. In one case, *Saxon v. Georgia Association of Insurance Agents*, 399 F.2d 1010 (5th Cir. 1968), the court held that a national bank does not have authority to operate a general life and casualty insurance agency, arguing that the grant of insurance agency powers in section 92 implicitly prohibits national banks not located in small towns from selling fire, life, or other general insurance.

We disagree with the *Saxon* court's interpretive approach under section 92. The legislative history of section 92 indicates that the Comptroller of the Currency proposed it in 1916 to provide an additional source of revenue for national banks located in small towns.[9] The United States Courts of Appeal for the District of Columbia Circuit and the Eighth Circuit have, in dicta, construed section 92 consistently with the legislative history and have concluded that section 92 does not affect the powers of national banks located in towns that have a population larger than 5,000.[10] This has been the traditional position of the OCC[11]

However, even under the *Saxon* court's interpretation of section 92, that section should not bar national banks from brokerage of fixed annuities. As the court observed in *IBAA v. Heimann*, *Saxon* should only apply to products such as "broad forms of automobile, home, casualty and liability insurance," 613 F.2d 1164, 1170 (D.C. Cir. 1979), and not to more specialized forms of insurance such as credit life insurance. This limitation on *Saxon* is implicit in section 92 itself. Section 92 concerns the power of a national bank to act as agent for "any fire, life, or other general insurance company." Under the doctrine of *"ejusdem generis,"* general words that follow an enumeration of specific examples are read to apply only to other items akin to those specifically enumerated. This doctrine confines section 92, and therefore *Saxon*, to types of insurance that are similar to fire and life insurance, such as other general casualty insurance policies. Therefore, section 92, even as the *Saxon* court interpreted it, does not affect the power of a national bank to sell more specialized products that are incidental to the business of banking, such as title insurance, credit life and disability insurance, and debt cancellation contracts.[12] Like title insurance, credit life insurance, and debt cancellation contracts, fixed annuity contracts are a specialized product, unrelated to the general life and casualty policies that section 92 concerns, that banks have authority to sell as agent.

Indeed, it is doubtful that the word "insurance" in section 92 can be construed to include annuities. Since the term is not defined in section 92, it should be given its common meaning.[13] Dictionary definitions of "insurance" invariably describe it as a contract for indemnification against risk of loss. For example, *Black's Law Dictionary* (1979) defines "insurance" as follows:

> A contract whereby, for a stipulated consideration, one party undertakes to compensate the other for loss on a specified subject by specified perils. . . . A contract whereby one undertakes to indemnify another against loss, damage, or liability arising from an unknown or contingent event and is applicable only to some contingency or act to occur in future. An agreement by which one party for a consideration promises to pay

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[8] Although banks do not ordinarily use actuarial calculations in setting interest rates, there are no limitations on how a bank may determine the interest rate paid on a deposit.

[9] *See* 53 Cong. Rec. 11001 (1916) (letter from Comptroller Williams)

[10] *See IBAA v. Heimann*, 613 F.2d 1164, 1170, n. 18 (D.C. Cir. 1979), *cert. denied* 449 U.S. 823 (1980) (Section 92 "[b]y its own terms does not address the authority of national banks in larger towns or cities to act as agents for life insurance companies."), *Independent Insurance Agents of America v. Board of Governors of the Federal Reserve*, 736 F.2d 468, 477, n. 6 (8th Cir. 1984) ("There is a strong argument that *Saxon* was wrongly decided. The legislative history indicates that Congress was concerned only with providing small-town banks with an additional profit source, not with prohibiting city banks from selling insurance.").

[11] *See* Interpretive Letter No. 331, April 4, 1985, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,501

[12] *See* Interpretive Letter No. 368 (July 11, 1986), *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,538 (national bank may act as agent in the sale of title insurance incidental to authority to make loans secured by real property), Interpretive Letter No. 377 (February 6, 1987), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 85,601 (operating subsidiary of national bank may underwrite title insurance for its mortgage loan customers). 12 CFR 7.7495 (national banks may enter into debt cancellation contracts), 12 CFR 2.6 (national banks may also issue credit life insurance or sell credit life insurance as agent)

[13] *See* 2A Sutherland, *Statutory Construction* 47.28 (4th ed. 1984)

money or its equivalent or to do an act valuable to other party upon destruction, loss, or injury of something in which another party has an interest.

*See also Webster's Third International Dictionary* (1971) ("coverage by contract whereby for a stipulated consideration one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril"), *Random House Dictionary* (1973) ("coverage by contract in which one party agrees to indemnify or reimburse another for any loss that occurs under the terms of the contract"); *Oxford English Dictionary* (Compact ed. 1971) ("a contract by which the one party (usually a company or corporation) undertakes, in consideration of a payment (called a *premium*) proportioned to the nature of the risk contemplated, to secure the other against pecuniary loss, by payment of a sum of money in the event of destruction of or damage to property (as by disaster at sea, fire, or other accident), or the death or disablement of a person"); *Helvering v. Le Gierse*, 312 U.S. 531, 542 (1941) ("Historically and commonly, insurance involves risk-shifting and risk-distributing."). Most authorities hold that annuities are not insurance, because they do not incorporate the element of indemnification against risk.[14] Courts considering the status of annuities as "insurance" have held that annuities are not insurance for purposes of federal tax law,[15] several state tax laws,[16] bankruptcy law,[17] and other laws.[18] Although annuities often share with insurance the need for actuarial calculations, they are primarily a vehicle for investment, not indemnification.

A few authorities have characterized annuities as "insurance." Most significantly, the cases construing the scope of section 3(a)(8) of the Securities Act of 1933, 15 U.S.C. 77c(a)(8), (exempting annuity and insurance contracts from the registration requirements of the Securities Act of 1933)[19] occasionally speak of fixed annuities as being "insurance" rather than "securities."[20] The exemption expressly covers both annuity contracts and insurance contracts, but the cases discuss the issue in terms of the distinction between "insurance" and "securities."[21] The cases disregard state cases defining insurance on the grounds that the extent to which annuity contracts are insurance under a federal statute is a federal question.[22] The principal issue in these cases is the degree of investment risk that an annuity may incorporate without becoming a security subject to the Securities Act registration requirements. Those annuities that are exempt are labelled "insurance" and those that are not are labelled "securities."

These cases should not be read as holding that fixed annuity contracts are insurance for purposes of federal banking law. First, the holdings in these cases only address the applicability or inapplicability of the annuity exemption in section 77c(a)(8) to a particular instrument. The courts' characterization of the annuities in question as "insurance" is, therefore, dicta. Second, the analysis used to distinguish "insurance" annuities from "security" annuities only makes sense in the context of the federal securities laws. The standard that has emerged in this area focuses almost entirely on investment purpose and investment risk, so that an

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[14] *See generally* 1 J. Appleman, Insurance Law and Practice, 84 (1981) ("annuity contracts must . . . be recognized as investments rather than as insurance").

[15] *See Helvering v. LeGierse*, 312 U.S. 531, 542 (1941), *Keller v. Commissioner of Internal Revenue*, 312 U.S. 543 (1941 (Under federal tax law which excludes "amounts receivable as insurance" from decedent's gross estate for tax purposes, annuities are not treated as insurance.)

[16] *See Kernochan v. U.S.*, 29 F Supp. 860 (Ct. Cl. 1939); *In re Sothern's Estate*, 257 A.D. 574, 14 N.Y.S.2d 1 (1939), *In re Rhodes' Estate* 197 Misc. 232, 94 N.Y.S. 2d 406 (N.Y. Surr. Ct. 1949) (Annuity contracts are not within New York tax law exemption, applicable to insurance payable to a designated beneficiary, from estate taxes.), *People v. Knapp* 193 A.D. 413, 184 N.Y.S. 345 (1920), *Commonwealth v. Metropolitan Life Ins. Co.*, 254 Pa. 510, 98 A. 1072 (1916) *Daniel v. Life Ins. Co. of Virginia*, 102 S.W.2d 256, 260 (Tex. Civ. App. 1937) *State v. Ham*, 54 Wyo. 148, 88 P.2d 484 (1939) (Consideration paid for annuity contracts is not subject to tax law which taxes all "premiums" paid for insurance, because annuities are not insurance.)

[17] *See In re Walsh* 19 F Supp. 567 (D. Minn. 1937) (Annuity policy owned by bankrupt was not within insurance exemption to Minnesota bankruptcy law and therefore trustee in bankruptcy was entitled to the cash surrender value of the policies.) *In Re Howerton* 21 Bankr. 621, 623 (1982).

[18] *See Carroll v. Equitable Life Assurance Co.*, 9 F Supp. 223 (W.D. Mo. 1934) (Defendant, a mutual insurance company forbidden by law to issue insurance contracts except by a "mutual plan," was nonetheless authorized to sell annuity contracts without a mutual plan because annuity contracts are investments rather than insurance.), *Succession of Rabouin*, 201 La. 227, 9 So 2d 529 (1942) (Insurance is not considered part of the decedent's estate for purposes of the law of "forced heirship," but annuities are part of the estate because they are not insurance.).

[19] Section 3(a)(8) is quoted *supra*, n. 2

[20] *See SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959), *SEC v. United Benefit Life Ins. Co*, 387 U.S. 202 (1966); *Otto v. Variable Annuity Life Ins. Co.*, 814 F 2d 1127 (1986)

[21] *See, e.g., SEC v. Variable Life Ins. Co.*, 359 U.S. 65, 75 (1959) (Opinion of Brennan, J.) ("The point [of the exemption] must have been that there then was a form of 'investment' known as insurance (including 'annuity contracts') which did not present very squarely the sort of problems that the Securities Act and the Investment Company Act were devised to deal with, and which were, in many details, subject to a form of state regulation of a sort which made the federal regulation even less relevant."), *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 210-211 (same). *Otto v. Variable Annuity Life Ins. Co.*, 814 F 2d 1127, 1141

[22] *See SEC v. Variable Annuity Life Ins. Co.* 359 U.S. at 68-69

annuity may qualify for the "insurance" exemption even if it is totally lacking in mortality risk.[23] This standard is clearly narrowly tailored to the specific purposes of the Securities Act of 1933 and is therefore not useful in construing the term "insurance" generally.

Even under the *Saxon* court's reading of section 92, therefore, section 92 does not affect the power of a national bank to sell annuities as agent. Under the *Saxon* court's interpretation, section 92 only limits a national bank's power to sell general life and casualty insurance. This limitation does not apply to annuities because they are, like credit life insurance, a specialized product that banks have authority to sell as agent, and because, in any case, they are not insurance for purposes of section 92 since they lack the basic insurance characteristic of indemnification against risk.

## Supervisory Issues

Sale of fixed annuities as agent is a logical complement to other financial services offered by the Bank, such as financial planning, investment counseling, and discount brokerage services. State banks are already offering this product to customers. This activity will provide a valuable additional source of income and will help the Bank to compete effectively with other providers of financial services. Since the Bank will act only as agent, the Bank will not have a principal stake in annuity contracts and therefore will incur no interest rate or actuarial risks.

Customers will benefit from the increased range of products made available to them by the Bank. Brochures, forms, and the prospectus describing the Certificates clearly and conspicuously state that the Certificates are a product of the insurance company issuer. The risk that customers may confuse the Certificates with federally insured deposit accounts is, therefore, minimal. As an additional safeguard against such confusion, however, the Bank should expressly disclose in its own advertising and promotional materials, and the Bank's employees should disclose when describing the Certificates to customers, that the Certificates are not products of the Bank and are not FDIC insured. Moreover, the Bank should obtain from the customer before a sale is made a signed statement that the customer understands that (1) the annuity product is an obligation of the issuing insurance company and not of the Bank, (2) the Bank is acting only as agent for the insurance company, and (3) the obligation is not FDIC insured.

[23] *See* SEC Rule 151, 17 CFR 230 151, SEC Securities Act Release No 6645 (May 29, 1986), *reprinted in* [1986-87 Transfer Binder] Fed Sec. L. Rep (CCH) ¶ 84,004

Finally, the Bank should determine whether any state laws govern this activity, and to the extent that they do should comply fully with them.

## Incentive Program

The proposed incentive program is legally permissible Twelve CFR 7.5000 provides that "(a) national bank may adopt any reasonable bonus or profit sharing plan designed to insure adequate remuneration of bank officers and employees." However, incentive pay programs must be undertaken with care. At the same time that such programs further legitimate interests of the Bank, they have the potential for creating unintended incentives for employees to engage in improper activities, such as illegal product tie-ins and unsound lending. *See* Interpretive Letter No. 86, from John G. Heimann, Comptroller of the Currency (April 3, 1979), *reprinted in* [1978-79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,161 (providing discussion of concerns with one such program and some guidelines for addressing). Thus, in the design and implementation of such programs, banks must evaluate the potential for such unintended effects created by their proposed program's specific provisions and take special care to ensure that there are adequate policies and procedures to counter such potentialities. In this case, for instance, the Bank should have controls in place to ensure, at a minimum, that product tying is avoided and that all required disclosures are made by employees in the sale of the annuity product.

## Percentage Lease

The OCC has conditioned banks' authority to lease on a percentage basis on their observance of the safeguards enumerated in Interpretive Letter No. 274 (December 2, 1983), *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,438. If the requirements stated in that letter are met, then the percentage leasing arrangement will be permissible.

For the foregoing reasons, I conclude that the activities proposed for the Bank are permissible under the National Bank Act. The Bank will be expected to comply with the requirements set forth above relating to disclosures in the Bank's promotional materials and employee representations and the receipt of a signed customer statement, and to the design and implementation of its incentive pay program and percentage lease arrangement.

Paul Allan Schott
Chief Counsel

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## 500 — December 26, 1989

This responds to your request to the * * * field office for a ruling on whether two corporate bonds held by the * * * (the "Bank") should be combined under 12 CFR 32.5 (1988). The bonds in question are issued by related companies. One is a $1,000,000 par value 10.1 percent Three-Year Extendable Note issued by the * * * (the "Parent"), and the other is a $600,000 Zero Coupon Guaranteed Note issued by * * * (the "Subsidiary") on the Euro-bond market. The Parent is the guarantor of the Subsidiary's bond.

The Subsidiary is a * * * corporation wholly owned by the Parent and formed to obtain financing for the Parent outside the United States. Both bond issues were used to finance short-term debt acquired by the Parent when it brought a manufacturing firm's assets several years ago. The Parent receives its income from sales of goods and services throughout the United States and the world, while the Subsidiary receives its income from financial transactions with the Parent, related subsidiaries of the Parent, and the Euro-market.

The lending limits of 12 U.S.C. 84 (1982 & Supp. IV 1988) — and implementing regulations at 12 CFR 32 — do not apply to investment securities purchased and held by a national bank for its own account. Section 84 applies only to limit the amount of loans extended by a bank to a single borrower, not securities held by a bank for investment. These holdings are instead controlled by 12 U.S.C. 24 (Seventh), which states: "In no event shall the total amount of the investment securities of any one obligor or maker held by the association for its own account exceed at any time 10 per centum of its [unimpaired capital and surplus]." The Comptroller has issued regulations to implement this provision, allowing, among other things, national banks to hold corporate debt securities like those in question if such securities meet certain standards of marketability and quality set out in the regulations and subsequent rulings. *See* 12 CFR 1.5, 1.7 and 1.9.

As you note, 12 CFR 32.5 dictates that "loans or extensions of credit" to separate borrowers engaged in a "common enterprise" are to be combined when calculating lending limits under 12 U.S.C. 84. Clearly, were the bond purchases in question "loans or extensions of credit," the combination rules would require combination of the bonds. As the lending limit rules make clear, however, "[t]he lending limits prescribed by 12 U.S.C. 84 are separate and distinct from the investment limits prescribed by 12 U.S.C. 24." 12 CFR 32.111. The bonds in question are not subject to 12 CFR 32.

Although 12 U.S.C. 24 (Seventh) and 12 U.S.C. 84 are separate, they share the objective of requiring national banks to safeguard the bank's depositors by requiring diversification of the bank's investments and extensions of credit among different persons and companies. To ensure that this objective is met, regulations issued under 12 U.S.C. 84 specifically address the question of when loans to one person should be attributed to other persons. *See* 12 CFR 32.5. However, no equivalent rule has been promulgated requiring the debt securities of related corporations to be treated as obligations of a single obligor for purposes of applying the investment limitation of 12 U.S.C. 24 (Seventh) and 12 CFR 1. Nevertheless, the investment security regulations embody the principle that a bank must consider all factors relevant to the obligor's ability to repay a bond or other debt security, including whether repayment is dependent on performance by other entities not named as obligors on the security.

The bank's responsibility to undertake this analysis is inherent in the regulation establishing the purchase standards for investment securities. That regulation provides that a bank must exercise its prudent banking judgment to determine that "there is adequate evidence that an obligor will be able to perform all that it undertakes to perform in connection with the security, including all debt service requirements." 12 CFR 1.5(a). If a named obligor's ability to perform is based on the economic performance of a related company and the bank relies on the presence of that economic relationship as well as a legal obligation of that other entity, in the form of a guarantee or similar legally enforceable agreement, in determining that a security qualifies as an eligible investment security, then the bank should recognize that reliance by treating the related corporation as an obligor on the security.

The basic principle that banks must consider is who is the economic obligor on a debt security in determining how to comply with the statutory investment limit is clearly expressed in the regulations governing indirect general obligations of a state. Under those regulations, obligations issued by an obligor not possessing general powers of taxation may nevertheless qualify as a general obligation of a state or political subdivision if an obligor possessing general powers of taxation has unconditionally promised to make sufficient funds available to make all payments required in connection with the obligation. *See* 12 CFR 1.3(g) and 1.120.

The principle that banks must look beyond the named obligor when complying with the investment limit is also codified in Interpretive Ruling 7570. *See* 12 CFR 7.7570 (allowing a separate 10 percent limit to each security issue of a single issuer if the proceeds of the issue are

used to acquire and lease real estate to economically and legally separate industrial tenants). In addition, this subject has been discussed in various letters. *See, e.g.*, Investment Securities Letter No. 29 (August 3, 1988), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,899 (securities issued by separate trusts but collateralized by loans of one company which also provides a partial guarantee against losses must be combined as obligations of that company); Interpretive Letter No. 7 (December 12, 1977), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,082 (combination of separate series of mortgage-backed securities issued by one entity); Investment Securities Letter No. 3 (July 17, 1976), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,873 (discussing whether an issue of variable-rate demand notes guaranteed by a third-party bank had to be combined with other securities guaranteed by that bank).

In this case, the Subsidiary's repayment is dependent upon receipts from the Parent and related companies, as is the market valuation of the Subsidiary's bonds. Moreover, the Parent has bound itself to make certain payments to bondholders if the Subsidiary fails to meet its repayment obligations. In view of these factors the Parent should be considered an obligor on the bonds of the Subsidiary. Accordingly, the bonds of the Parent and Subsidiary should be considered debt obligations issued by one obligor and combined in calculating the 10 percent securities holding limit for the Bank.

Since the Bank's combined holdings of the bonds of the Parent and Subsidiary exceed 10 percent of the Bank's capital and surplus, those holdings are in violation of 12 U.S.C. 24 (Seventh) and 12 CFR 1. Consequently, the Bank will have to take appropriate steps to bring its holdings into conformance with the investment limit.

William B. Glidden
Assistant Director
Legal Advisory Services Division

* * *

## No Objection Letters

### 90-1 — February 16, 1990

This is in response to your letters and subsequent telephone conversations in which you requested a staff "no objection" position with respect to a proposal by The Chase Manhattan Bank, N.A. (the "Bank"), to expand its swap activities to include acting as principal in unmatched commodity price index swaps with its customers. Subject to the limitations discussed below OCC staff would not object to the Bank proceeding with its proposal.

#### The Proposal

The Bank currently acts as principal in matched and unmatched interest rate and currency swaps and in accordance with Staff No-Objection Letter No. 87-5 (July 20, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 84,034, it also acts as principal in matched commodity price index swaps. In the swap contracts, the Bank acts as a financial intermediary between parties that want to limit certain financial risks resulting from variations in interest rates, exchange rates, or commodity prices. The contracts are financial agreements only, providing for cash payments between the parties based in part on variations in interest rates, exchange rates, or commodity prices. Although a Bank may purchase foreign currency to satisfy its obligation under a currency swap, at no time are the parties to a commodity swap contract required or permitted to deliver the commodity on which the price index is based in order to satisfy their obligations under the swap contract.

In matched commodity price index swaps, the Bank enters into separate but offsetting contracts with a producer and user of a commodity. The contracts provide that the Bank will make or receive payments based on a notational quantity of a commodity and the value of a designated commodity price index at specified dates. In contracts with producers, the Bank agrees to make a payment if the value of the index has decreased and will receive a payment if the value of the index has increased. In contracts with users, the Bank agrees to make a payment if the value of the index has increased and will receive a payment if the value of the index has decreased.

Currently, the Bank only engages in commodity price index swaps when it can simultaneously enter into contracts with a producer and a user that are fully matched with regard to quantity, index, and maturity. Although the Bank prefers to enter into swaps on a fully matched basis, this is not always possible given the different needs of its customers. Consequently, the Bank now proposes to conduct its commodity price swap activities in the same manner as its interest rate and currency swaps by acting as principal in unmatched as well as matched commodity price swaps.

The Bank's unmatched commodity swap program will be operated in substantially the same manner as its program for matched swaps so that the Bank receives payments when its counterparties are in the best financial position to make them. The Bank will continue to

conduct its standard credit risk analysis of the proposed counterparty to the swap contract, and will enter into swap contracts only with sophisticated institutional customers that have a specific Bank-developed risk rating which is consistent with the Bank's credit policy. As with matched commodity price swaps, the contracts will provide a cap and floor to price index variations so that the total payments due under the contract would be limited

Under its proposal, the Bank would no longer wait until perfectly matched offsetting swap contracts are available before entering into a commodity price index swap agreement with a counterparty. Instead, it will enter into swap agreements and hedge any unmatched commodity price risk exposure by purchasing and selling exchange-traded commodity futures with the intention of entering into offsetting commodity price swaps if they become available. In hedging any commodity price risk associated with unmatched swaps contracts, the Bank will settle the futures contracts in cash and will never take delivery of the commodity underlying the futures. Nor will the Bank use the unmatched contracts or futures to speculate in commodity price movements.

## Discussion

Interest rate, currency, and commodity price index swaps are individually negotiated contracts through which a national bank performs its traditional role as a financial intermediary helping its customers meet various financial objectives. Although of recent development, the total interest rate and currency swap market is now estimated at $1.1 trillion. *See* Henderson, *Swap Credit Risk: A Multi-Perspective Analysis*, 44 Bus. Law. 365 (1989). National banks participate in this form of financial intermediation pursuant to their authority to exercise "all such incidental powers as shall be necessary to carry on the busines of banking." 12 U.S.C. 24(7).

As discussed more fully in Staff No Objection Letter No. 87-5, *supra*, from a conceptual perspective, "[t]he very object of banking is to aid the operation of the laws of commerce by serving as a channel for carrying money from place to place, as the rise and fall of supply and demand require." *Auten v. United States National Bank of New York*, 174 U.S. 140, 141 (1899). Moreover, the evolutionary nature of the business of banking and the necessity of banks devloping new products to keep up with the changing financial needs of the economy are now well established in case law. *See, e.g., M&M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977) (confirming the authority of national banks to lease motor vehicles stating "we believe the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking") *cert. denied*, 436 U.S. 956 (1978); *American Insurance Association v. Clarke*, 865 F.2d 278, 281 (rejecting "a narrow and artifically rigid view of both the business of banking and the [National Bank Act]" which would have prevented national banks from providing municipal bond insurance as a new form of a traditional banking product). A swap contract in which payments are based on commodity prices instead of interest rates or currency exchange rates fits within the powers of national banks because it is simply a new way of tailoring traditional intermediation services of commercial banks to meet the needs of bank customers.

Even though swap contracts are a relatively new means by which banks offer financial intermediation services, they are related to the deposit and lending activities authorized for national banks under 12 U.S.C. 24(7). In performing its deposit-taking and lending functions, a bank acts as an intermediary between customers who wish to receive income for the use of their money and those who need financing and are willing to pay for the use of borrowed funds. The bank satisfies these needs by acting as principal in individual contracts that result in payments being transferred between depositors and borrowers. As part of the process of intermediating between these customers, the Bank undertakes to make payments to depositors and, based on its evaluation of the creditworthiness of the borrowers, its assumes the credit risk that the borrowers will not make the payments required under their loan contracts with the bank.

When taking deposits and making loans, national banks are permitted to enter into contracts which provide for interest payments which have fixed or variable rates. As the OCC explained in the Decision of the Office of the Comptroller of the Currency on the Request by Chase Manhattan Bank, N.A., to Offer the Chase Market Index Investment Deposit Account, national banks have the authority to establish the amount of the payments to be made and received under their deposit and loan contracts based on market conditions and the needs of their customers. Accordingly, a bank may determine the amount of those payments by reference to any index or standard as long as the bank complies with safe and sound banking principles and, in the case of loans, with state usury laws.

Banks have used this authority to offer deposit and loan contracts with interest payments tied to various indexes including foreign exchange rates, yields on securities issued by the U.S. Treasury, the Standard and Poors 500 (S&P 500) stock index, and the price of gold

Under these contracts, banks have permissibly incurred the incidental risk associated with fluctuations in the index used to measure the amount of the payments they made or received. Long ago, the OCC made it clear that a national bank may use futures contracts to hedge exposure from payment obligations and income sources that fluctuated with various interest rates. *See* Banking Circular 79, 3d Rev. (April 19, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 99,539 (authorizing the purchase and sale of futures contracts for purposes of asset-liability management). More recently, the OCC has recognized that a national bank may use futures to hedge its exposure on payment obligations linked to other indexes. *See* Decision of the Office of the Comptroller of the Currency on the Request by Chase Manhattan Bank, N.A., to Offer the Chase Market Index Investment Deposit Account (approving the purchase of S&P 500 futures to hedge interest rate risk associated with a deposit account paying interest based in part on the S&P 500 stock index).

A bank entering into unmatched commodity price swaps is essentially engaging in activities which have previously been approved for national banks in other forms. A commodity price swap contract involves the same types of payments that a bank makes and receives in connection with its deposit and loan contracts. However, unlike a deposit or loan, no principal is received or disbursed by the bank with a swap. Instead, payments are made based on a notational amount of the commodity and changes in an agreed upon commodity price index. Moreover, the purchase and sale of futures to hedge unmatched swaps is equivalent to using futures to hedge exposure on deposits or loans with interest rates linked to movements in the price of a commodity.

Through its proposed commodity price swap program, the Bank will help its customers reduce financial risks associated with fluctuations in the prices of commodities they use or produce. The Bank achieves this by acting as a conduit to pass the risk on to others who are willing to assume those financial risks. In the case of perfectly matched swaps, the Bank's counterparties in offsetting contracts share the risk of commodity price fluctuations among themselves. This is because payments made when prices move in favor of users are transferred to producers through the Bank's offsetting swap contracts, while the reverse occurs when prices move in favor of the producers. Thus, the users assume the risk of falling prices by agreeing to make the payments indirectly received by producers when commodity prices decline, while producers assume the risk of rising prices by indirectly paying users when commodity prices rise. In the case of unmatched swaps, the risk of price fluctuations is passed on to the futures markets by the Bank's purchase and sale of futures contracts to hedge that risk.

Just as with its deposit and lending activities, in matched and unmatched swap transactions the Bank acts solely as a financial intermediary on behalf of its customers, making and receiving payments. Although those payments have the effect of transferring the risk of fluctuations in commodities prices, the Bank itself never retains unhedged commodity price risk. The only risk the Bank explicitly retains is credit risk, the risk that a counterparty will not make payments according to the terms of the contract. This is the same risk the Bank assumes when it makes a loan. Furthermore, any residual commodities price risk the bank retains as a result of the inability of any hedging strategy to perfectly offset the exposure from an unmatched swap is not qualitatively different from the risks a bank may permissibly encounter when offering a deposit account with interest payments tied to the same commodity. Thus, by entering into unmatched commodity price swap contracts, a bank does not undertake any risks that are qualitatively different from those met in the course of two of banking's most fundamental activities: making loans and taking deposits.

As evidenced by their treatment in the Basle Agreement on capital standards and the risk-based capital guidelines issued by the federal banking agencies, interest rate and currency swap contracts are widely recognized as products which may be offered by national banks. *See, e.g.*, OCC Risk-Based Capital Guidelines, 54 Fed. Reg. 4177, 4178, 4182 (to be codified as Appendix A to 12 CFR 3). Moreover, in major legislation which, *inter alia*, restructured the deposit insurance funds for commercial banks and thrifts and defined the powers of the Federal Deposit Insurance Corporation to act as conservator or receiver of banks and thrifts, Congress has specifically recognized commodity swaps as products offered by banks and thrifts. *See* Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 212(a) (defining a swap agreement as "any agreement . . . which is a rate swap agreement, basis swap, commodity swap, forward rate agreement, . . . or any other similar agreement . . ." and including swaps within the definition of "qualified financial contract" in amendments to section 11 of the Federal Deposit Insurance Act (12 U.S.C. 1821)); *see also* Policy Statement Concerning Swap Transactions, 54 Fed. Reg. 30694, 30697 (stating CFTC policy not to regulate certain swap contracts which are undertaken by commercial banks "in conjunction with a line of business, including financial intermediation services"). This is further confirmation that swap activities, including unmatched commodity price swaps, are part of or incidental to the business of banking and permissible activities for na

tional banks under 12 U.S.C. 24(7).[1]

As with any activity conducted by the Bank, the commodity price swap program must be carried out in accordance with safe and sound banking principles to ensure that the risks encountered are appropriately managed. At a minimum, this means the Bank must have in place controls of the type required by Banking Circular 79. This includes specific written policies endorsed by the board of directors governing the operation of the swap program and addressing overall risk, internal controls and procedures, appropriate position limits, and hedging activities. In determining appropriate exposure limits, the Bank may wish to take into consideration the principles for netting multiple interest rate and currency swap contracts with a single counterparty set forth in section 3(b)(5) of OCC's Risk-Based Capital Guidelines, 54 Fed. Reg. 4182.

For the reasons discussed above, the staff will not object to the Bank's expansion of its swap activities to include acting as principal in unmatched commodity price index swaps with its customers. Please note that this position is based on the facts and representations made in your letters and telephone conversations with us and any material changes in the facts or conditions may result in a different conclusion.*

William B. Glidden
Assistant Director, Legal Advisory Services Division

*Note. Enclosures from bank counsel and others are omitted. Complete copies may be obtained from the Communications Division.

* * *

[1] A similar conclusion has been reached by the New York State Banking Department which has stated that the activities involved in offering loans, deposits and derivatives thereof, including swaps, linked to commodity prices or indexes "constitute such incidental powers as shall be necessary or appropriate to carry on the business of banking" within the meaning of the banking laws applicable to New York State-chartered banks. Letter from David T. Halverson, First Deputy Superintendent, to Bankers Trust Company (November 14, 1988).

## Trust Interpretations

### 242 — December 28, 1989

This is in reply to your letter dated November 27, 1989.

It is your understanding that the OCC has taken the interpretive position that a bank trustee must, without exception, disclose the dollar amount of fees and expenses that are attributed to a trust account investing in the mutual funds advised by the bank. In your letter you request relief from the requirement of "line item" disclosure.

Your research indicates that calculating the specific dollar amount of fees and expenses presents programming challenges. Also, the cost of providing the disclosure on a periodic basis would be prohibitive. The specific disclosure of the amount of fees and expenses chargeable to an account puts banks at a decided competitive disadvantage with nonbank trust organizations. It is your belief that the fund prospectus should be sufficient disclosure. However, you propose to furnish a statement of the fees/expenses on a percentage basis with a customer's accounting. Such percentage disclosure would be made at least annually.

As a matter of policy, the OCC will not require, on a *per se* basis, such "line item" disclosure. However, banks are cautioned that the fiduciary law of a given jurisdiction may require such disclosure. Such duty may be present when acting in certain fiduciary capacities or when compensation is received by the fiduciary as a result of the exercise of its discretion as a fiduciary.

Dean E. Miller
Deputy Comptroller for Compliance

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### 243 — December 28, 1989

This is in reply to your letter dated November 8, 1989.

It remains the opinion of the OCC that the sub-transfer agent arrangement presents a conflict of interest subject to 12 CFR 9.12 and is a possible prohibited transaction under ERISA. The sub-transfer agent arrangement was described and discussed in our letter of October 30, 1989 to a national bank examiner.

The following addresses the points raised in your letter.

A national bank performing the activities of a transfer agent, as that term is defined in Securities Exchange

Act of 1934, would be subject to SEC Rules 17Ad-1 and 17Ad-14. However, alleged compliance with these rules would not be justification to breach the fiduciary's duty of undivided loyalty.

The basis of the Federal Reserve Bank of Kansas City letter of August 24, 1987 was discussed with the staff of the Board of Governors. It is our understanding that their opinion was based upon representations that the sub-transfer agent performed sufficient additional services to warrant receiving a fee. We were provided with contrary information.

Section 9.12 of Part 9 prohibits a national bank fiduciary to enter into certain transactions where there exists such an interest as might affect the exercise of the best judgement of the bank. The arrangement came to our attention as a result of a concerned trust banker. When approached by a salesperson for your bank services, he was, in essence, told that his bank could receive the sub-transfer agent fee without performing additional services. The banker contacted the OCC to confirm that, "all banks are doing it" and that the OCC condones the practice.

The substance of the arrangement is the receipt of financial benefits by the fiduciary as a result of investing trust funds in a particular investment. Under the arrangement, the fiduciary becomes the nominal sub-transfer agent as a result of investing in the mutual fund. This is distinguishable from the situation where a bank performs corporate shareholder services as a function apart from the fiduciary services rendered to individual clients. In the latter case, the bank performs the services for the general public and becoming the transfer agent is not the direct result of investing in the security. See *Matter of Sheehan*, 106 N.Y.S. 2d 908 (1951).

We agree that some transactions that would otherwise be an act of divided loyalty do not pose a regulatory concern because of their *de minimus* nature. The salesperson's single $18.00 lunch for the trustee may be such an example. Under the sub-transfer agent arrangement the bank receives $18 (subject to increase based upon the Consumer Price Index) for each subaccount. The essence of the arrangement is for the sub-transfer agent to receive substantial financial benefits.

Dean E. Miller
Deputy Comptroller for Compliance

* * *

Attachment
October 30, 1989

This is in reply to your request for a ruling concerning an arrangement whereby a national bank (Bank A) is to receive sub-transfer agent fees as a result of investing fiduciary, custody, and ERISA accounts in a mutual fund.

Based upon the facts presented and information learned through conversations with the banker involved and other regulators, the arrangement presents a conflict of interest subject to 12 CFR 9.12, and is a possible prohibited transaction under ERISA.

Under the arrangement, Bank A would receive sub-transfer agent fees as a result of causing fiduciary accounts, including those subject to ERISA, and custody accounts to invest in the mutual fund. The mutual fund appoints Bank B to provide transfer agent services for shareholders pursuant to an agreement between Bank B and the mutual fund. The agreement provides that to the extent the transfer agency services are performed by a correspondent bank that maintains an omnibus account with Bank B for multiple shareholders, compensation may be paid by the fund to the correspondent (Bank A). In the example provided, the compensation to be received is $18.00 per annum for each shareholder account.

The conflict arises from the Bank A receiving third party compensation as a result of investing account assets in the mutual fund. Bank A has placed itself in a position of divided loyalty by entering into an agreement to receive third party compensation as a result of the management of funds belonging to others. The selection of the mutual fund can no longer be said to be unbiased since the bank is to receive compensation from that mutual fund. In terms of 12 CFR 9.12, because of the arrangement to receive sub-transfer agent fees, the mutual fund becomes "an organization in which there exists such an interest as might affect the exercise of the best judgement of the bank in acquiring the property."

No information has been provided which would establish that the arrangement is lawful for a fiduciary under state law. For Bank A to lawfully engage in the arrangement for its fiduciary accounts which are subject to the common law of trusts, specific authorization would have to be provided by the terms of governing instruments, by court orders or by consent of all parties in interest.

Discussions with members of DOL headquarters staff indicate the arrangement would be viewed as a possible prohibited transaction. Specifically, section 406(b)(1) of ERISA provides that "a fiduciary with respect to a plan shall not deal with the assets of the plan in his own interest or for his own account." In the case at hand, Bank A, a fiduciary as defined by ERISA, will be investing plan assets in a manner which results in the bank receiving money from a third party. As you are aware, a prohibited transaction may not be authorized by the plan sponsor.

As we analyze the arrangement, the bank is producing no (or at best, insignificant) additional records as a designated sub-transfer agent. Consequently, most if not all of the sub-transfer agent fees will be additional unearned compensation. The bank financially benefits as a result of its investment decision. If the fee represented a recovery of expenses, then the result may be different under ERISA. *See* 29 CFR 2550.408(b)(2)(e) pertaining to a fiduciary recovering actual expenses.

In the situation of a pure agency/custody account, the bank may argue that it has no fiduciary duty since it is not making the investment decision. This would be too narrow a view of an agent's fiduciary responsibilities. An agent has a duty to deal fairly with its principal. This concept is discussed in further detail in Trust Interpretation No. 222, dated May 15, 1989. When presenting the mutual fund as an investment for the agency account, the bank/agent should disclose the fees it will receive as a result of the sub-transfer agent arrangement. The principal has a right to be informed of the agent's interest in the transaction presented by the agent.

* * *

## 244 — December 4, 1989

This is in reply to your letter dated October 26, 1989. You request guidance regarding securities lending by common trust funds for personal trusts.

The procedures established by the Department of Labor in Prohibited Transaction Exemptions (PTEs) 81-6 and 82-63 would not be applicable to a common trust fund for personal trusts. The PTEs contemplate an independent fiduciary being informed and consenting to a program of securities lending and compensation. In the traditional personal trust relationship the bank is the only fiduciary to the account. Under ERISA, the fiduciary has an affirmative duty to act. As proposed, it is questionable that mere acquiescence by a customer would be sufficient under the doctrine of consent as established by the common law of trusts.

Notification would not be adequate authorization for a common trust fund to engage in securities lending and to divide the fees received between the bank and the common trust fund. *See* 12 CFR 9.18(b)(1) & (12).

We trust that this provides the guidance that you requested.

Billy L. Dowdle
Director for Trust Activities

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## 245 — January 22, 1990

Your letter of December 6, 1989 concerns the authorization necessary for a common trust fund to engage in securities lending.

It is our opinion that if a common trust fund (CTF) is to engage in securities lending, the common trust plan should specifically authorize the activity. It is preferable for the instrument of each account participating in the CTF to authorize the trustee to engage in security lending. If specific authorization is not obtained, the trustee should determine that security lending is legally permissible for each account participating in the fund.

Outside counsel was unable to find any state statute or decision specifically addressing a trustee engaging in security lending. In our opinion, specific authorization should be obtained. This would be necessary since the trustee has not established that the general investment powers of a fiduciary include security lending.

Also, the bank proposes to take a portion of the income generated by the CTF security lending activities. Apparently, additional fees would be charged because the service is an ancillary non-traditional activity for a trustee. In these circumstances, notification would not be adequate authorization for a CTF to engage in security lending and to divide the income received between the bank and the CTF. *See* 12 CFR 9.18(b)(12).

Dean E. Miller
Deputy Comptroller for Compliance

* * *

## 246 — January 22, 1990

We received your letter dated January 21, 1990, concerning the valuation of guaranteed investment contracts in collective investment funds. The bank was

cited for a violation of 12 CFR 9 18(b)(1) with respect to its valuation of guaranteed investment contracts on a cost basis. For various reasons cited, the bank believes that valuing guaranteed investment contracts on a cost basis does not violate 12 CFR 9.18(b)(1).

Based upon the information presented, we are unable to conclude that guaranteed investment contracts should be automatically valued on a cost basis when held as an investment in the bank's Guaranteed Investment Fund.

The OCC has issued several interpretive letters dealing with guaranteed investment contracts and their valuation. *See* Trust Interpretive Letters Nos. 152, 194, 197, and 211. The basic point of the guidance provided by the OCC is that, although there is no one method of valuing assets for which a market quotation is not readily available, a good faith determination of the fair value (as required by the regulation) requires more than a conclusion that because guaranteed investment contracts in a collective investment fund are not traded on an open market, the "fair value" is "cost."

Additionally, there are different factors and considerations present when guaranteed investment contracts are used as an investment in a collective investment fund as opposed to a single employee benefit plan. Valuing these contracts and other assets based upon valuation considerations applicable to employee benefit accounts may not result in a fair and equitable valuation as necessary for a collective investment fund. A principal characteristic of a collective investment fund is that fund units are purchased and redeemed at least quarterly. Other fiduciary accounts, such as employee benefit accounts, do not have similar characteristics.

In conclusion, we would expect the bank, as trustee for the fund, to determine the fair value of the guaranteed investment contracts held as investments. Such a determination must be documented in the bank's records each valuation date. Many different factors would be involved in the determination of fair value. *See* Trust Interpretive Letter No. 212 for a discussion of those factors.

Dean E. Miller
Deputy Comptroller for Compliance

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# Mergers — January 1 to March 31, 1990

*Mergers consummated involving two or more operating banks.*

A number of transactions in this section do not have an accompanying decision. In those cases the OCC reviewed the competitive effects of the proposals by using its standard procedures for determining whether the transaction has minimal or no adverse competitive effects. The OCC found the proposals satisfied its criteria for transactions that clearly had no or minimal adverse competitive effects.

## THE FIRST NATIONAL BANK OF ANCHORAGE, Anchorage, Alaska, and First Federal Savings Bank of Alaska, Anchorage, Alaska

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| The First National Bank of Anchorage, Anchorage, Alaska (12072), with | $1,071,385,000 |
| and First Federal Savings Bank of Alaska, with | —* |
| merged January 12, 1990, under charter and title of the former. The merged bank at date of merger had | — |

* * *

## SECURITY PACIFIC BANK OF ALASKA, NATIONAL ASSOCIATION, Anchorage, Alaska, and Home Savings Bank, F.S.B., Anchorage, Alaska

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Security Pacific Bank of Alaska, National Association, Anchorage, Alaska (18023), with | $170,793,000 |
| and Home Savings Bank, F.S.B., Anchorage, Alaska, with | — |
| merged January 12, 1990, under charter and title of the former. The merged bank at date of merger had | — |

* * *

## WELLS FARGO BANK, NATIONAL ASSOCIATION, San Francisco, California, and Valley National Bank, Glendale, California

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Wells Fargo Bank, National Association, San Francisco, California (1741), with | $44,952,463,000 |
| and Valley National Bank, Glendale, California (14823), with | 286,405,000 |
| merged January 1, 1990, under charter and title of the former. The merged bank at date of merger had | 45,035,059,000 |

* * *

### COMPTROLLER'S DECISION

On October 2, 1989, application was made to the Office of the Comptroller of the Currency (OCC) by WF Interim Bank, National Association, San Francisco, California (hereinafter, "WF Interim"), for prior authorization to consolidate with Valley National Bank, Glendale, California (hereinafter "Valley") under the charter and title of Valley National Bank. The application was filed in conjunction with an application to subsequently merge Valley National Bank with and into Wells Fargo Bank, National Association, San Francisco, California (hereinafter "Wells") under the charter and title of Wells Fargo Bank, National Association. The applications were based on an agreement completed between the proponents on September 8, 1989.

As of June 30, 1989, Valley had total deposits of $225 million and operated seven offices. Valley is an independent bank. As of the same date, Wells had total deposits of $33,736 million and operated an extensive statewide branching network. Wells is wholly owned by Wells Fargo & Co., a single bank holding company.

The OCC has reviewed the competitive effects of this proposal by using the standard procedures for determining whether a consolidation clearly has minimal or no adverse competitive effects. The office finds that the proposal satisfies the criteria for a consolidation that clearly has no or minimal adverse competitive effects.

The Bank Merger Act requires this office to consider ". . . the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." We find that the financial and managerial resources of Valley and Wells do not raise concerns that would cause the application to be disapproved. The future prospects of the resulting institution are considered favorable and are expected to meet the convenience and needs of the community to be served.

A review of the record of this application and other information available to this office as a result of its regulatory responsibilities under the Community Reinvestment Act (CRA) revealed no evidence that Valley's or Wells' records of helping meet the credit needs of its community, including low- and moderate-income neighborhoods, is less than satisfactory.

*Data not available

We have analyzed this proposal pursuant to the Bank Merger Act (12 U S C 1828(c)) and find that it will not lessen significantly competition in any relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved subject to the conditions noted in a separate communication to Wells

December 1, 1989

SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

## WELLS FARGO BANK, NATIONAL ASSOCIATION, San Francisco, California, and American National Bank, Bakersfield, California

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Wells Fargo Bank, National Association, San Francisco, California (1741), with | $45,272,755,000 |
| and American National Bank, Bakersfield, California (15437), with | 887,816,000 |
| merged March 31, 1990, under charter and title of the former. The merged bank at date merger had | 46,161,846,000 |

* * *

## MESA NATIONAL BANK, Grand Junction, Colorado, and Valley Federal Savings and Loan Association, Grand Junction, Colorado, and Mesa Federal Savings and Loan Association, Grand Junction, Colorado

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Mesa National Bank, Grand Junction, Colorado (22182), with | $ — |
| and Valley Federal Savings and Loan Association, Grand Junction, Colorado, with | — |
| and Mesa Federal Savings and Loan Association, Grand Junction, Colorado, with | — |
| merged February 2, 1990, under charter and title of the former. The merged bank at date of merger had | — |

* * *

## FIRST UNION NATIONAL BANK OF FLORIDA, Jacksonville, Florida, and Florida National Bank, Jacksonville, Florida

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| First Union National Bank of Florida, Jacksonville, Florida (17695), with | $ 8,945,960,000 |
| and Florida National Bank, Jacksonville, Florida (8321), with | 7,465,256,000 |
| merged March 1, 1990, under charter and title of the former. The merged bank at date of merger had | 16,473,106,000 |

* * *

## COMMERCEBANK, NATIONAL ASSOCIATION, Miami, Florida, and Miami National Bank, Miami, Florida

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Commercebank, National Association, Miami, Florida (16804), with | $108,926,000 |
| and Miami National Bank, Miami, Florida (14791), with | 47,471,000 |
| merged March 23, 1990, under charter and title of the former. The merged bank at date of merger had | 157,397,000 |

* * *

## FIRST SECURITY BANK OF IDAHO, NATIONAL ASSOCIATION, Boise, Idaho, and Twin Falls Bank & Trust Company, Twin Falls, Idaho

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| First Security Bank of Idaho, National Association, Boise, Idaho (14444), with | $1,784,661,000 |
| and Twin Falls Bank & Trust Company, Twin Falls, Idaho, with | 197,549,000 |
| merged January 12, 1990, under charter and title of the former. The merged bank at date of merger had | 1,953,067,000 |

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### COMPTROLLER'S DECISION

On July 12, 1989, application was made to the Office of the Comptroller of the Currency (OCC) for prior approval to merge Twin Falls Bank and Trust Company, Twin Falls, Idaho (hereinafter, "TFB") into First Security Bank of Idaho, National Association, Boise, Idaho (hereinafter, "First Security") under the charter and title of the latter. The application is based on an agreement finalized between the proponents on April 20, 1989.

As of March 31, 1989, TFB, an independent bank, held total deposits of $156 million and operated five offices. As of the same date, First Security held total deposits of $1.5 billion and operated 73 offices. First Security is wholly owned by First Security Corporation, a $5.2 billion multibank holding company with 161 banking offices in Idaho, Utah, and Wyoming.

The relevant geographic market for this proposal is the area including and immediately surrounding Twin Falls. This is the area where TFB, the bank to be acquired, derives the bulk of its banking business. Based on the services and products offered by both the commercial bank and thrift institutions in the relevant market, we find that they are direct competitors. Thus, total deposits of thrift institutions are included for this analysis. There are six commercial banks and four savings and loan associations competing in the relevant market. TFB is the largest competitor in the market with a share of 26 percent. First Security is ranked fourth in the market with a share of 6 percent. Consummation of this proposal will result in First Security replacing TFB as the largest competitor in the market with a share of 31 percent. Although one competitor will be eliminated from the market, five banks and four savings and loan associations will remain in the market, including five of the largest financial institutions in the state of Idaho. Based on the number of competitors remaining in the relevant market and the number of competitors that could legally enter the market, the OCC believes that consummation of this proposal will not have a significantly adverse effect on competition.

The Bank Merger Act requires the OCC to consider ". . . the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the communities to be served." First Security has the financial and managerial resources to absorb TFB without adversely affecting its overall condition. The future prospects of the resulting bank are favorable, as are the effects of the proposal on the convenience and needs of the general public to be served.

A review of the record of this application and other information available to the OCC as a result of its regulatory responsibilities under the Community Reinvestment Act (CRA) revealed no evidence that the applicants' record of helping to meet the credit needs of their communities, including low- and moderate-income neighborhoods, is less than satisfactory.

We have reviewed this proposal pursuant to the Bank Merger Act (12 U.S.C. 1828(c)) and find that it does not significantly lessen competition in the relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved.

November 21, 1989

### SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

## FIRST OF AMERICA BANK-KANKAKEE, NATIONAL ASSOCIATION, Kankakee, Illinois, and First Trust Bank, National Association, Kankakee, Illinois

| Names of institutions and type of transaction | Total assets |
|---|---|
| First of America Bank-Kankakee, National Association, Kankakee, Illinois (4342), with | $161,978,000 |
| First Trust Bank, National Association, Kankakee, Illinois (21812), with | 199,498,000 |
| merged February 1, 1990, under charter 21812 and title "First of America Bank-Kankakee County, National Association." The merged bank at date of merger had | 367,366,000 |

* * *

## FIRST OF AMERICA BANK-ILLINOIS, NATIONAL ASSOCIATION, Peoria, Illinois, and Commercial National Bank of Peoria, Peoria, Illinois

| Names of institutions and type of transaction | Total assets |
|---|---|
| First of America Bank-Illinois, National Association, Peoria, Illinois (22084), with | $91,081,000 |
| and Commercial National Bank of Peoria, Peoria, Illinois, (3296), with | 715,440,000 |
| merged February 1, 1990, under charter and title of the former. The merged bank at date of merger had | 806,240,000 |

* * *

## FIRST OF AMERICA BANK-NORTHEAST ILLINOIS, NATIONAL ASSOCIATION, Libertyville, Illinois, and First of America Bank-Zion, Zion, Illinois

| Names of institutions and type of transaction | Total assets |
|---|---|
| First of America Bank-Northeast Illinois, National Association, Libertyville, Illinois (15594), with | $351,968,000 |
| and First of America Bank-Zion, Zion, Illinois, with | 105,749,000 |
| merged March 1, 1990, under charter and title of the former. The merged bank at date of merger had | 465,864,000 |

* * *

## MAGNA BANK, NATIONAL ASSOCIATION, Belleville, Illinois, and Magna Bank of Belleville, Belleville, Illinois

| Names of institutions and type of transaction | Total assets |
|---|---|
| Magna Bank, National Association, Belleville, Illinois (2154), with | $ 674,000,000 |
| Magna Bank of Belleville, Belleville, Illinois, with | 254,249,000 |
| merged March 1, 1990, under charter and title of the former. The merged bank at date of merger had | 928,224,000 |

* * *

## FIRST OF AMERICA BANK-ROCKFORD, NATIONAL ASSOCIATION, Rockford, Illinois, and United Bank of Illinois, National Association, Rockford, Illinois

| Names of institutions and type of transaction | Total assets |
|---|---|
| First of America Bank-Rockford, National Association, Rockford, Illinois (14511), with | $217,628,000 |
| and United Bank of Illinois, National Association, Rockford, Illinois (14533), with | 337,487,000 |
| merged March 9, 1990, under charter 14533 and title "First of America Bank-Rockford, National Association." The merged bank at date of merger had | 562,202,000 |

* * *

## CITIZENS BANK OF GIBSON COUNTY, NATIONAL ASSOCIATION, Princeton, Indiana, and Haubstadt State Bank, Haubstadt, Indiana

| Names of institutions and type of transaction | Total assets |
|---|---|
| Citizens Bank of Gibson County, National Association, Princeton, Indiana (9463), with | $55,257,000 |
| and Haubstadt State Bank, Haubstadt, Indiana, with | 41,066,000 |
| merged January 1, 1990, under charter and title of the former. The merged bank at date of merger had | 107,583,000 |

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## AMERITRUST NATIONAL BANK, CENTRAL INDIANA,
Indianapolis, Indiana, and The Boone County State Bank, Lebanon, Indiana

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Ameritrust National Bank, Central Indiana, Indianapolis, Indiana (16018), with | $403,942,000 |
| and The Boone County State Bank, Lebanon, Indiana, with | 144,673,000 |
| merged February 24, 1990, under charter and title of the former. The merged bank at date of merger had | 554,631,000 |

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## NORWEST BANK DES MOINES, NATIONAL ASSOCIATION,
Des Moines, Iowa, and Norwest Bank Denison, National Association, Denison, Iowa, and Norwest Bank Fort Dodge, National Association, Fort Dodge, Iowa, and Norwest Bank Mason City, National Association, Mason City, Iowa, and Norwest Bank Ottumwa, National Association, Ottumwa, Iowa, and Norwest Bank Sioux City, National Association, Sioux City, Iowa, and Norwest Bank Atlantic, National Association, Atlantic, Iowa, and Norwest Bank Cedar Falls, National Association, Cedar Falls, Iowa, and Norwest Bank Cedar Rapids, National Association, Cedar Rapids, Iowa

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Norwest Bank Des Moines, National Association, Des Moines, Iowa (2307), with | $1,403,058,000 |
| and Norwest Bank Denison, National Association, Denison, Iowa (4784), with | 47,868,000 |
| and Norwest Bank Fort Dodge, National Association, Fort Dodge, Iowa (2763), with | 141,572,000 |
| and Norwest Bank Mason City, National Association, Mason City, Iowa (2574), with | 153,991,000 |
| and Norwest Bank Ottumwa, National Association, Ottumwa, Iowa (107), with | 64,872,000 |
| and Norwest Bank, Sioux City, National Association, Sioux City, Iowa (5022), with | 254,455,000 |
| and Norwest Bank Atlantic, National Association, Atlantic Iowa (20443), with | 90,695,000 |
| and Norwest Bank Cedar Falls, National Association, Cedar Falls, Iowa (14421), with | 77,721,000 |
| and Norwest Bank Cedar Rapids, National Association, Cedar Rapids, Iowa (117), with | 355,154,000 |
| merged January 1, 1990, under charter 2307 and title "Norwest Bank Iowa, National Association." The merged bank at date of merger had | 2,589,386,000 |

* * *

## WEST CARROLL NATIONAL BANK OF OAK GROVE,
Oak Grove Louisiana, and First National Bank of Louisiana, Bastrop, Louisiana

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| West Carroll National Bank of Oak Grove, Oak Grove, Louisiana (14593), with | $56,971,000 |
| and First National Bank of Louisiana, Bastrop, Louisiana (17972), with | 8,151,000 |
| merged February 28, 1990, under charter and title of the former. The merged bank at date of merger had | 62,822,000 |

* * *

## BANK OF NEW ENGLAND, NATIONAL ASSOCIATION,
Boston, Massachusetts, and Bank of New England-Worcester, Worcester, Massachusetts, and Bank of New England-South, National Association, Brockton, Massachusetts, and Bank of New England-North, National Association, Lowell, Massachusetts

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Bank of New England, National Association, Boston, Massachusetts (475), with | $13,946,985,000 |
| Bank of New England-Worcester, Worcester, Massachusetts, with | 1,194,979,000 |
| and Bank of New England-South, National Association, Brockton, Massachusetts (779), with | 1,486,988,000 |
| and Bank of New England-North, National Association, Lowell, Massachusetts (6077), with | 1,653,217,000 |
| merged February 9, 1990, under charter 475 and title "Bank of New England, National Association." The merged bank at date of merger had | 17,643,377,000 |

* * *

## FIRST OF AMERICA BANK-UPPER PENINSULA, NATIONAL ASSOCIATION,
Marquette, Michigan, and First of America Bank-Iron Mountain, National Association, Iron Mountain, Michigan

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| First of America Bank-Upper Peninsula, National Association, Marquette, Michigan (12027), with | $287,207,000 |
| and First of America Bank-Iron Mountain, National Association, Iron Mountain, Michigan (14452), with | 73,964,000 |
| merged January 1, 1990, under charter and title of the former. The merged bank at date of merger had | 361,171,000 |

* * *

## COMERICA BANK, NATIONAL ASSOCIATION,
## Jackson, Michigan, and Comerica Bank-Kalamazoo, Kalamazoo, Michigan, and Comerica Bank-Midland, Midland, Michigan, and Comerica Bank-Lansing, National Association, Lansing, Michigan, and Comerica Bank-Battle Creek, Battle Creek, Michigan, and Comerica Bank-Hackley, National Association, Muskegon, Michigan, and Comerica Bank-Ann Arbor, National Association, Ann Arbor, Michigan

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Comerica Bank, National Association, Jackson, Michigan (13741), with | $882,589,000 |
| and Comerica Bank-Kalamazoo, Kalamazoo, Michigan, with | 232,940,000 |
| and Comerica Bank-Midland, Midland, Michigan, with | 146,565,000 |
| and Comerica Bank-Lansing, National Association, Lansing, Michigan (20234), with | 13,812,000 |
| and Comerica Bank-Battle Creek, Battle Creek, Michigan, with | 145,272,000 |
| and Comerica Bank-Hackley, National Association, Muskegon, Michigan (4398), with | 330,410,000 |
| and Comerica Bank-Ann Arbor, National Association, Ann Arbor, Michigan (15164), with | 208,107,000 |
| merged January 1, 1990, under charter 13741 and title "Comerica Bank, National Association." The merged bank at date of merger had | 1,920,714,000 |

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## NORWEST BANK MINNESOTA SOUTH, NATIONAL ASSOCIATION,
## Fairbault, Minnesota, and Norwest Bank Northfield, Northfield, Minnesota

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Norwest Bank Minnesota South, National Association, Fairbault, Minnesota (11668), with | $209,152,000 |
| and Norwest Bank Northfield, Northfield, Minnesota, with | 73,594,000 |
| merged February 1, 1990, under charter and title of the former. The merged bank at date of merger had | 282,746,000 |

* * *

## HERITAGE NATIONAL BANK,
## North St. Paul, Minnesota, and First National Bank in St. Charles, St. Charles, Minnesota

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Heritage National Bank, North St. Paul, Minnesota (17714), with | $28,356,000 |
| and First National Bank in St. Charles, St. Charles, Minnesota (13973), with | 27,140,000 |
| merged February 9, 1990, under charter 13973 andd title of the former. The merged bank at date of merger had | 55,404,000 |

* * *

## THE LAKE CRYSTAL NATIONAL BANK,
## Lake Crystal, Minnesota, and First State Bank of Good Thunder, Good Thunder, Minnesota

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| The Lake Crystal National Bank, Lake Crystal, Minnesota (13972), with | $41,215,000 |
| and First State Bank of Good Thunder, Good Thunder, Minnesota, with | 11,105,000 |
| merged February 9, 1990, under charter and title of the former. The merged bank at date of merger had | 52,132,000 |

* * *

## COMMERCE BANK OF SPRINGFIELD, NATIONAL ASSOCIATION,
## Springfield, Missouri, and Commerce Bank-Nixa, National Association, Nixa, Missouri

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Commerce Bank of Springfield, National Association, Springfield, Missouri (21538), with | $507,542,000 |
| and Commerce Bank-Nixa, National Association, Nixa, Missouri (18753), with | 9,663,000 |
| merged January 1, 1990, under charter and title of the former. The merged bank at date of merger had | 515,500,000 |

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## FIRST BANK (NATIONAL ASSOCIATION)-BILLINGS,
Billings, Montana, and First National Bank in Miles City, Miles City, Montana, and First Bank (National Association)-Southside Missoula, Missoula, Montana, and First Bank (National Association)-Western Montana Missoula, Missoula, Montana, and First Westside National Bank of Great Falls, Great Falls, Montana, and The First National Bank of Great Falls, Great Falls, Montana, and The First National Bank in Havre, Havre, Montana, and First National Bank & Trust Company of Helena, Helena, Montana, and First National Bank in Bozeman, Bozeman, Montana, and First Bank Butte, National Association, Butte, Montana, and First Bank West Billings, Billings, Montana

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| First Bank (National Association)-Billings, Billings, Montana (12407), with | $258,527,000 |
| and First National Bank in Miles City, Miles City, Montana (12536), with | 67,442,000 |
| and First Bank (National Association)-Southside Missoula, Missoula, Montana (14809), with | 45,253,000 |
| and First Bank (National Association)-Western Montana Missoula, Missoula, Montana (3995), with | 201,206,000 |
| and First Westside National Bank of Great Falls, Great Falls, Montana (14733), with | 68,889,000 |
| and The First National Bank of Great Falls, Great Falls, Montana (3525), with | 225,016,000 |
| and The First National Bank in Havre, Havre, Montana (11077), with | 65,214,000 |
| and First National Bank & Trust Company of Helena, Helena, Montana (4396), with | 150,147,000 |
| and First National Bank in Bozeman, Bozeman, Montana (4968), with | 96,836,000 |
| and First Bank Butte, National Association, Butte, Montana (18528), with | 109,707,000 |
| and First Bank West Billings, Billings, Montana, with | 80,222,000 |
| merged January 1, 1990, under charter 12407 and title "First Bank Montana, National Association." The merged bank at date of merger had | 1,379,115,000 |

* * *

## FIRST NH BANK, NATIONAL ASSOCIATION,
Manchester, New Hampshire, and First Cheshire Bank, Keene, New Hampshire

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| First NH Bank, National Association, Manchester, New Hampshire (1520), with | $620,611,000 |
| and First Cheshire Bank, Keene, New Hampshire, with | 91,520,000 |
| merged February 28, 1990, under charter and title of the former. The merged bank at date of merger had | 712,101,000 |

* * *

## MIDLANTIC NATIONAL BANK/NORTH,
West Paterson, New Jersey, and County Trust Company, Lyndhurst, New Jersey

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Midlantic National Bank/North, West Paterson, New Jersey (15709), with | $3,705,241,000 |
| and County Trust Company, Lyndhurst, New Jersey, with | 7,989,000 |
| merged March 31, 1990, under charter and title of the former. The merged bank at date of merger had | 3,710,130,000 |

* * *

## KEY BANK, NATIONAL ASSOCIATION,
Albany, New York, and Key Bank of Southeastern New York, National Association, Newburgh, New York

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Key Bank, National Association, Albany, New York (1301), with | $2,316,833,000 |
| and Key Bank of Southeastern New York, National Association, Newburgh, New York (1349), with | 1,132,849,000 |
| merged March 8, 1990, under charter 1301 and title "Key Bank of Eastern New York, National Association." The merged bank at date of merger had | 3,449,638,000 |

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## MARINE MIDLAND BANK, NATIONAL ASSOCIATION,
Buffalo, New York, and Marine Midland Bank (Delaware), National Association, Wilmington, Delaware

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Marine Midland Bank, National Association, Buffalo, New York (16833), with | $21,605,248,000 |
| and Marine Midland Bank (Delaware), National Association, Wilmington, Delaware (20538), with | 2,227,242,000 |
| merged March 30, 1990, under charter and title of the former. The merged bank at date of merger had | 23,832,490,000 |

* * *

## FIRST NATIONAL BANK IN GRAND FORKS,
## Grand Forks, North Dakota, and First National Bank South, Grand Forks, North Dakota

| Names of institutions and type of transaction | Total assets |
|---|---|
| First National Bank in Grand Forks, Grand Forks, North Dakota (13790), with | $213,541,000 |
| and First National Bank South, Grand Forks, North Dakota (22074), with | 26,247,000 |
| merged February 16, 1990, under charter and title of the former. The merged bank at date of merger had | 238,773,000 |

* * *

## FIRST NATIONAL BANK,
## Hettinger, North Dakota, and First State Bank of Regent, North Dakota, Regent, North Dakota

| Names of institutions and type of transaction | Total assets |
|---|---|
| First National Bank, Hettinger, North Dakota (8991), with | $ 23,008,000 |
| and First State Bank of Regent, North Dakota, Regent, North Dakota, with | 9,717,000 |
| merged February 22, 1990, under charter and title of the former. The merged bank at date of merger had | — |

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## THE FIFTH THIRD BANK OF NORTHWESTERN OHIO, NATIONAL ASSOCIATION,
## Findlay, Ohio, and The Home Banking Company, Gibsonburg, Ohio

| Names of institutions and type of transaction | Total assets |
|---|---|
| The Fifth Third Bank of Northwestern Ohio, National Association, Findlay, Ohio (36), with | $455,790,000 |
| and The Home Banking Company, Gibsonburg, Ohio, with | 78,241,000 |
| merged February 28, 1990 under charter and title of the former. The merged bank at date of merger had | 534,031,000 |

* * *

## SOCIETY BANK, NATIONAL ASSOCIATION,
## Dayton, Ohio, and Society Bank, Columbus, Ohio

| Names of institutions and type of transaction | Total assets |
|---|---|
| Society Bank, National Association, Dayton, Ohio (10), with | $1,884,393,000 |
| Society Bank, Columbus, Ohio, with | 677,352,000 |
| merged March 2, 1990, under charter and title of the former. The merged bank at date of merger had | 2,546,688,000 |

* * *

## BANK ONE, LIMA, NATIONAL ASSOCIATION,
## Lima, Ohio, and United National Bank, Convoy, Ohio, and The Metropolitan Bank of Lima, Lima, Ohio

| Names of institutions and type of transaction | Total assets |
|---|---|
| Bank One, Lima, National Association, Lima, Ohio (15340), with | $134,843,000 |
| and United National Bank, Convoy, Ohio (8017), with | 40,576,000 |
| and The Metropolitan Bank of Lima, Lima, Ohio with | 216,032,000 |
| merged March 30, 1990, under charter 15340 and title "Bank One, Lima, National Association." The merged bank at date of merger had | 391,451,000 |

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### COMPTROLLER'S DECISION

On June 14, 1989, application was made to the Office of the Comptroller of the Currency (OCC) for prior authorization to merge United National Bank, Convoy, Ohio and The Metropolitan Bank of Lima, Lima, Ohio into Bank One, Lima, National Association, Lima, Ohio. This application is based on an agreement finalized between the proponents on April 17, 1989.

As of March 31, 1989, United National Bank held total deposits of $38 million and operated three offices. As of the same date, The Metropolitan Bank of Lima held total deposits of $185 million and operated seven offices. Bank One, Lima, National Association held total deposits of $125 million as of March 31, 1989 and operated six offices. United National Bank and The Metropolitan Bank of Lima are wholly owned subsidiaries of Metropolitan Bancorp, Inc., and Bank One, Lima, National Association is controlled indirectly by Bank One Corporation.

There are two separate and distinct geographic markets relevant to this proposal. The first relevant market is the area including and immediately surrounding Convoy. This is the area where Metropolitan Bancorp

operates three offices. Bank One Corporation does not compete in this market. This transaction will result in one competitor replacing another in the Convoy market. Consequently, consummation of this proposal should not have an adverse effect on competition in the Convoy market.

The second relevant geographic market is the area including and immediately surrounding Lima. There are six commercial banks and five savings and loan associations with 30 offices competing within this market. Bank One Corporation is ranked fifth in the market with a share of 12 percent. Metropolitan Bancorp is ranked second in the market with a share of 16 percent. Consummation of this transaction will result in Bank One Corporation becoming the largest competitor in the Lima market with a share of 28 percent. Although one competitor will be eliminated from the relevant market, five commercial banks and five savings and loan associations will remain, including several of the largest financial institutions in the state. Additionally, recent changes in Ohio banking law, which now allows statewide branching, have enhanced the ability of numerous competitors to gain entry into the Lima market. Consequently, consummation of this proposal should not have a significantly adverse effect on competition in the Lima market.

The Bank Merger Act requires the OCC to consider ". . . the financial and managerial resources and future prospects of the existing and proposed institutions and the convenience and needs of the community to be served." Bank One, Lima, National Association has the managerial and financial resources to absorb the subject banks without adversely affecting its overall condition. The future prospects of the bank are favorable, as are the effects of the proposal on the convenience and needs of the general public to be served.

A review of the record of this application and other information available to the OCC as a result of its regulatory responsibilities under the Community Reinvestment Act (CRA) revealed no evidence that the applicants' record of helping to meet the credit needs of their communities, including low- and moderate-income neighborhoods, is less than satisfactory.

We have reviewed this proposal pursuant to the Bank Merger Act (12 U.S.C. 1828(c)) and find that it does not significantly lessen competition in the relevant markets. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved.

September 7, 1989

## SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

## UNITED STATES NATIONAL BANK OF OREGON, Portland, Oregan, and Yaquina Bay Bank, Newport, Oregon

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| United States National Bank of Oregon, Portland, Oregon (4514), with | $9,143,478,000 |
| and Yaquina Bank Bank, Newport, Oregon, with | 36,910,000 |
| merged March 29, 1990, under charter and title of the former. The merged bank at date of merger had | 9,178,234,000 |

* * *

## PENNSYLVANIA NATIONAL BANK AND TRUST COMPANY, Pottsville, Pennsylvania, and Hamburg Savings and Trust Company, Hamburg, Pennsylvania

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Pennsylvania National Bank and Trust Company, Pottsville, Pennsylvania (1), with | $730,904,000 |
| and Hamburg Savings and Trust Company, Hamburg, Pennsylvania, with | 93,408,000 |
| merged January 31, 1990, under charter and title of the former. The merged bank at date of merger had | 824,312,000 |

* * *

## FIRST AMERICAN NATIONAL BANK,
Nashville, Tennessee, and First American National Bank, Chattanooga, Tennessee, and First American Bank, Clarksville, Clarksville, Tennessee, and First American Bank, Cookeville, Tennessee, and First American National Bank of Jackson, Jackson, Tennessee, and First American National Bank, Kingsport, Tennessee, and First American National Bank, Knoxville, Tennessee, and First American Bank, Memphis, Tennessee, and First American Bank, Murfreesboro, Murfreesboro, Tennessee

| Names of institutions and type of transaction | Total assets |
|---|---|
| First American National Bank, Nashville, Tennessee (3032), with | $3,030,713,000 |
| and First American National Bank, Chattanooga, Tennessee (1666), with | 254,623,000 |
| and First American Bank, Clarksville, Clarksville, Tennessee, with | 260,042,000 |
| and First American Bank, Cookeville, Tennessee, with | 167,337,000 |
| and First American National Bank of Jackson, Jackson, Tennessee (2168), with | 431,899,000 |
| and First American National Bank, Kingsport, Tennessee (10842), with | 583,860,000 |
| and First American National Bank, Knoxville, Tennessee (17839), with | 1,391,481,000 |
| and First American Bank, Memphis, Tennessee, with | 611,137,000 |
| and First American Bank, Murfreesboro, Murfreesboro, Tennessee, with | 116,896,000 |
| merged January 1, 1990, under charter 3032 and title "First American National Bank, Nashville, Tennessee." | |
| The merged bank at date of merger had | 6,847,988,000 |

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## NATIONAL COMMERCE BANK,
Houston, Texas, and Plaza Del Oro National Bank, National Association, Houston, Texas

| Names of institutions and type of transaction | Total assets |
|---|---|
| National Commerce Bank, Houston, Texas (20005), with | $ 65,020,000 |
| and Plaza Del Oro National Bank, National Association, Houston, Texas (18628), with | — |
| merged January 11, 1990, under charter and title of the former. The merged bank at date of merger had | — |

. . .

## THE FIRST NATIONAL BANK OF ANDERSON,
Anderson, Texas, and Farmers State Bank of Shiro, Shiro, Texas

| Names of institutions and type of transaction | Total assets |
|---|---|
| The First National Bank of Anderson, Anderson, Texas (7337), with | $ 32,980,000 |
| and Farmers State Bank of Shiro, Shiro, Texas, with | — |
| merged January 25, 1990, under charter and title of the former. The merged bank at date of merger had | — |

. . .

## HIBERNIA NATIONAL BANK IN TEXAS,
Pflugerville, Texas, and BancTexas Dallas, National Association, Dallas, Texas

| Names of institutions and type of transaction | Total assets |
|---|---|
| Hibernia National Bank in Texas, Pflugerville, Texas (22070), with | $296,225,000 |
| and BancTexas Dallas, National Association, Dallas, Texas (3985), with | 340,938,000 |
| merged January 26, 1990, under charter and title of the former. The merged bank at date of merger had | — |

. . .

## NCNB TEXAS NATIONAL BANK,
Dallas, Texas, and Tyler National Bank, Tyler, Texas

| Names of institutions and type of transaction | Total assets |
|---|---|
| NCNB Texas National Bank, Dallas, Texas (21834), with | $ 33,748,419,000 |
| and Tyler National Bank, Tyler, Texas (17691), with | — |
| merged February 1, 1990, under charter and title of the former. The merged bank at date of merger had | — |

. . .

## CITY NATIONAL BANK OF CARROLLTON,
## Carrollton, Texas, and Northway National Bank, Dallas, Texas

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| City National Bank of Carrollton, Carrollton, Texas (18559), with | $ — |
| and Northway National Bank, Dallas, Texas (17019), with | 19,138,000 |
| merged February 15, 1990, under charter and title of the former. The merged bank at date of merger had | — |

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## THE GAINSVILLE NATIONAL BANK IN GAINSVILLE,
## Gainsville, Texas, and First National Bank of Sanger, Sanger, Texas

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| The Gainsville National Bank in Gainsville, Gainsville, Texas (13698), with | $ 82,070,000 |
| and First National Bank of Sanger, Sanger, Texas (7886), with | 19,653,000 |
| merged March 1, 1990, under charter and title of the former. The merged bank at date of merger had | 100,649,000 |

* * *

## HIBERNIA NATIONAL BANK IN TEXAS,
## Pflugerville, Texas, and Search National Bank, Dallas, Texas

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Hibernia National Bank in Texas, Pflugerville, Texas (22070), with | $296,225,000 |
| Search National Bank, Dallas, Texas (20238), with | 21,155,000 |
| merged March 1, 1990, under charter and title of the former. The merged bank at date of merger had | — |

* * *

## NCNB TEXAS NATIONAL BANK,
## Dallas, Texas, and Centennial Federal Savings and Loan Association, Greenville, Texas

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| NCNB Texas National Bank, Dallas, Texas (21834), with | $ 33,748,419,000 |
| and Centennial Federal Savings and Loan Association, Greenville, Texas, with | — |
| merged March 2, 1990, under charter and title of the former. The merged bank at date of merger had | — |

* * *

## THE FIRST NATIONAL BANK OF HUGHES SPRINGS,
## Hughes Springs, Texas, and Liberty City State Bank, Liberty City, Texas

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| The First National Bank of Hughes Springs, Hughes Springs, Texas (6922), with | $33,031,000 |
| and Liberty City State Bank, Liberty City, Texas, with | 15,189,000 |
| merged March 16, 1990, under charter and title of the former. The merged bank at date of merger had. | — |

* * *

## BANK ONE, TEXAS, NATIONAL ASSOCIATION,
## Dallas, Texas, and American Bank of Arlington, Arlington, Texas

| *Names of institutions and type of transaction* | *Total assets* |
|---|---|
| Bank One, Texas, National Association, Dallas, Texas (21969), with | $ 12,271,581,000 |
| and American Bank of Arlington, Arlington, Texas, with | 28,327,000 |
| merged March 22, 1990 under charter and title of the former. The merged bank at date of merger had | — |

* * *

## THE FIRST NATIONAL BANK AT LUBBOCK,
Lubbock, Texas, and The Central National Bank of San Angelo, San Angelo, Texas

| Names of institutions and type of transaction | Total assets |
|---|---|
| The First National Bank at Lubbock, Lubbock, Texas (14208), with | $650,000,000 |
| and The Central National Bank of San Angelo, San Angelo, Texas (10664), with | 155,000,000 |
| merged March 22, 1990, under charter and title of the former. The merged bank at date of merger had | — |

• • •

## FIRST NATIONAL BANK OF BOWIE,
Bowie, Texas, and Alvord National Bank, Alvord, Texas

| Names of institutions and type of transaction | Total assets |
|---|---|
| First National Bank of Bowie, Bowie, Texas (4265) with | $135,737,000 |
| and Alvord National Bank, Alvord, Texas (12671), with | $7,616,000 |
| merged March 29, 1990, under charter and title of the former. The merged bank at date of merger had | — |

• • •

## FIRST CITY, TEXAS-SAN ANTONIO,
San Antonio, Texas, and Crown Bank, National Association, San Antonio, Texas

| Names of institutions and type of transaction | Total assets |
|---|---|
| First City, Texas-San Antonio, San Antonio, Texas (17941), with | $361,141,000 |
| and Crown Bank, National Association, San Antonio, Texas (18729), with | 22,767,000 |
| merged March 29, 1990, under charter and title of the former. The merged bank at date of merger had | — |

• • •

## BANK ONE, TEXAS, NATIONAL ASSOCIATION,
Dallas, Texas, and Everman National Bank of Fort Worth, Fort Worth, Texas

| Names of institutions and type of transaction | Total assets |
|---|---|
| Bank One, Texas, National Association, Dallas, Texas (21969), with | $12,271,581,000 |
| and Everman National Bank of Fort Worth, Forth Worth, Texas (15128), with | 65,941,000 |
| merged March 30, 1990, under charter and title of the former. The merged bank at date of merger had | — |

• • •

## THE FIRST HUNTINGTON NATIONAL BANK,
Huntington, West Virginia, and Guyan National Bank, Barboursville, West Virginia

| Names of institutions and type of transaction | Total assets |
|---|---|
| The First National Bank, Huntington, West Virginia (3106), with | $482,906,000 |
| and Guyan National Bank, Barboursville, West Virginia (16385), with | 23,523,000 |
| merged Februay 26, 1990, under charter and title of the former. The merged bank at date of merger had | 506,429,000 |

• • •

## THE MERCHANTS NATIONAL BANK,
Montgomery, West Virginia, and The Gauley National Bank, Gauley Bridge, West Virginia

| Names of institutions and type of transaction | Total assets |
|---|---|
| The Merchants National Bank, Montgomery, West Virginia, (9740), with | $73,810,000 |
| and The Gauley National Bank, Gauley Bridge, West Virginia (9850), with | 17,427,000 |
| merged March 1, 1990, under charter and title of the former. The merged bank at date of merger had | 90,323,000 |

• • •

## ASSOCIATED MANITOWOC BANK, NATIONAL ASSOCIATION,
Manitowoc, Wisconsin, and Associated Valders Bank, Valders, Wisconsin

| Names of institutions and type of transaction | Total assets |
|---|---|
| Associated Manitowoc Bank, National Association, Manitowoc, West Virginia (15972), with | $193,677,000 |
| and Associated Valders Bank, Valders, West Virginia, with | 25,585,000 |
| merged January 1, 1990, under charter and title of the former. The merged bank at date of merger had | 218,188,000 |

• • •

# Statistical Tables



NOTE: The statistical tables were produced by the Industry and Financial Analysis Division.

*Assets, liabilities and capital accounts of national banks, December 31, 1988, and December 31, 1989*
(Dollar amounts in millions)

| | Dec 31 1988 4,332 banks[1] | Dec 31 1989 4,163 banks[2] | Change Dec 31 1988 – Dec 31 1989 Fully consolidated | |
|---|---|---|---|---|
| | Consolidated foreign and domestic | Consolidated foreign and domestic | Amount | Percent |
| **Assets** | | | | |
| Cash and balances due from depository institutions | | | | |
| Noninterest-bearing balances and currency and coin | $ 131,815 | $ 139,620 | $ 7,805 | 5.9 |
| Interest-bearing balances | 76,038 | 71,723 | -4,314 | 5.7 |
| Securities | 275,142 | 294,794 | 19,652 | 7.1 |
| Federal funds sold and securities purchased under agreements to resell | 74,204 | 85,558 | 11,355 | 15.3 |
| Loans and leases, net of unearned income | 1,184,534 | 1,271,177 | 86,643 | 7.3 |
| Less allowance for loan and lease losses | 29,851 | 31,969 | 2,117 | 7.1 |
| Less allocated transfer risk reserve | 170 | 207 | 37 | 21.6 |
| Net loans and leases | 1,154,512 | 1,239,001 | 84,489 | 7.3 |
| Premises and fixed assets | 26,984 | 28,594 | 1,610 | 6.0 |
| Other real estate owned | 6,732 | 9,102 | 2,370 | 35.2 |
| All other assets | 100,606 | 107,997 | 7,391 | 7.3 |
| *Total assets* | 1,846,033 | 1,976,390 | 130,358 | 7.1 |
| **Liabilities** | | | | |
| Deposits: | | | | |
| Noninterest-bearing deposits in domestic offices | 280,363 | 285,110 | 4,747 | 1.7 |
| Interest-bearing deposits in domestic offices | 940,089 | 1,019,573 | 79,484 | 8.5 |
| Total domestic deposits | 1,220,452 | 1,304,684 | 84,231 | 6.9 |
| Total foreign deposits | 194,375 | 197,965 | 3,590 | 1.8 |
| Total deposits | 1,414,827 | 1,502,648 | 87,821 | 6.2 |
| Federal funds purchased and securities sold under agreements to repurchase | 156,239 | 185,190 | 28,950 | 18.5 |
| Demand notes issued to the U.S. Treasury | 17,430 | 14,505 | -2,925 | -16.8 |
| Other borrowed money | 73,822 | 78,179 | 4,357 | 5.9 |
| Subordinated notes and debentures | 9,131 | 11,714 | 2,583 | 28.3 |
| All other liabilities | 66,241 | 70,021 | 3,781 | 5.7 |
| *Total liabilities* | 1,737,690 | 1,862,257 | 124,567 | 7.2 |
| Limited-life preferred stock | 76 | 79 | 2 | 2.8 |
| **Equity capital** | | | | |
| Perpetual preferred stock | 825 | 794 | -31 | -3.7 |
| Common stock | 16,515 | 16,591 | 76 | 0.5 |
| Surplus | 39,831 | 42,573 | 2,742 | 6.9 |
| Net undivided profits and capital reserves | 51,544 | 54,463 | 2,919 | 5.7 |
| Cumulative foreign currency translation agreements | -322 | -376 | -55 | 17.0 |
| *Total equity capital* | 108,255 | 114,044 | 5,789 | 5.3 |
| *Total liabilities, limited-life preferred stock, and equity capital* | 1,846,033 | 1,976,390 | 130,358 | 7.1 |

[1]Revised figures
[2]Reporting national banks

# Assets, liabilities and capital accounts of national banks, by states, December 31, 1989
(Dollar amounts in millions)

| | Total United States | Alabama | Alaska | Arizona | Arkansas | [illegible] |
|---|---|---|---|---|---|---|
| Number of banks | 4,163 | 50 | 4 | 14 | [illegible] | [illegible] |
| **Assets** | | | | | | |
| Cash and balances due from depository institutions | | | | | | |
| Noninterest-bearing balances and currency and coin | $ 139,620 | $ 973 | $ 258 | $ 1,417 | $ 752 | $ [illegible] |
| Interest-bearing balances | 71,723 | 84 | 95 | 266 | 87 | [illegible] |
| Securities | 294,794 | 4,199 | 1,383 | 2,365 | 2,837 | [illegible] |
| Federal funds sold and securities purchased under agreements to resell | 85,558 | 271 | 201 | 433 | 635 | [illegible] |
| Loans and leases, net of unearned income | 1,271,177 | 10,063 | 1,309 | 11,809 | 5,406 | [illegible] |
| Less allowance for loan and lease losses | 31,969 | 144 | 28 | 555 | 94 | [illegible] |
| Less allocated transfer risk reserve | 207 | 0[1] | 0 | 0 | 0 | [illegible] |
| Net loans and leases | 1,239,001 | 9,919 | 1,280 | 11,254 | 5,312 | 159,462 |
| Premises and fixed assets | 28,594 | 239 | 89 | 338 | 191 | 3,346 |
| Other real estate owned | 9,102 | 38 | 16 | 219 | 55 | 1,044 |
| All other assets | 107,997 | 666 | 77 | 731 | 307 | 11,890 |
| *Total assets* | 1,976,390 | 16,389 | 3,399 | 17,022 | 10,176 | 217,768 |
| **Liabilities** | | | | | | |
| Deposits | | | | | | |
| Noninterest-bearing deposits in domestic offices | 285,110 | 2,421 | 812 | 3,211 | 1,608 | 38,766 |
| Interest-bearing deposits in domestic offices | 1,019,573 | 10,284 | 1,809 | 11,913 | 7,275 | 107,547 |
| Total domestic deposits | 1,304,684 | 12,705 | 2,621 | 15,124 | 8,883 | 146,313 |
| Total foreign deposits | 197,965 | 188 | 1 | 0 | 0 | 28,170 |
| Total deposits | 1,502,648 | 12,894 | 2,622 | 15,124 | 8,883 | 174,483 |
| Federal funds purchased and securities sold under agreements to repurchase | 185,190 | 1,945 | 355 | 583 | 305 | 11,935 |
| Demand notes issued to the U.S. Treasury | 14,505 | 57 | 23 | 1 | 34 | 320 |
| Other borrowed money | 78,179 | 21 | 0 | 311 | 16 | 7,784 |
| Subordinated notes and debentures | 11,714 | 0 | 0 | 23 | 10 | 3,755 |
| All other liabilities | 70,021 | 248 | 34 | 225 | 110 | 7,145 |
| *Total liabilities* | 1,862,257 | 15,164 | 3,034 | 16,267 | 9,358 | 205,422 |
| Limited-life preferred stock | 79 | 0 | 0 | 0 | 0 | 0 |
| **Equity capital** | | | | | | |
| Perpetual preferred stock | 794 | 0 | 0 | 0 | 0 | 378 |
| Common stock | 16,591 | 35 | 71 | 86 | 100 | 2,460 |
| Surplus | 42,573 | 440 | 90 | 285 | 251 | 3,711 |
| Net undivided profits and capital reserves | 54,463 | 750 | 203 | 383 | 467 | 5,914 |
| Cumulative foreign currency translation agreements | (376) | 0 | 0 | 0 | 0 | (116) |
| *Total equity capital* | 114,044 | 1,225 | 364 | 755 | 818 | 12,347 |
| *Total liabilities, limited-life preferred stock, and equity capital* | 1,976,390 | 16,389 | 3,399 | 17,022 | 10,176 | 217,768 |

[1]Zeros indicate amounts of less than $500,000.

*Assets, liabilities and capital accounts of national banks, by states, December 31, 1989*
(Dollar amounts in millions) — continued

| | Colorado | Connecticut | Delaware | District of Columbia | Florida | Georgia |
|---|---|---|---|---|---|---|
| Number of banks | 255 | 17 | 15 | 24 | 168 | 65 |
| **Assets** | | | | | | |
| Cash and balances due from depository institutions: | | | | | | |
| Noninterest-bearing balances and currency and coin | $ 1,922 | $ 1,972 | $ 405 | $ 1,247 | $ 7,422 | $ 3,562 |
| Interest-bearing balances | 916 | 21 | 69 | 2,057 | 1,780 | 945 |
| Securities | 3,939 | 2,459 | 159 | 2,613 | 16,928 | 6,692 |
| Federal funds sold and securities purchased under agreements to resell | 1,635 | 2,685 | 84 | 927 | 5,584 | 1,304 |
| Loans and leases, net of unearned income | 11,472 | 15,204 | 23,579 | 12,802 | 64,416 | 24,701 |
| Less allowance for loan and lease losses | 266 | 514 | 682 | 193 | 1,129 | 361 |
| Less allocated transfer risk reserve | 0 | 0 | 0 | 0 | 1 | 0 |
| Net loans and leases | 11,206 | 14,691 | 22,897 | 12,608 | 63,286 | 24,341 |
| Premises and fixed assets | 397 | 360 | 135 | 297 | 1,959 | 654 |
| Other real estate owned | 294 | 91 | 0 | 65 | 431 | 102 |
| All other assets | 572 | 1,223 | 1,391 | 611 | 2,901 | 1,163 |
| *Total assets* | 20,882 | 23,502 | 25,140 | 20,425 | 100,291 | 38,764 |
| **Liabilities** | | | | | | |
| Deposits: | | | | | | |
| Noninterest-bearing deposits in domestic offices | 4,210 | 4,175 | 387 | 2,890 | 15,167 | 7 405 |
| Interest-bearing deposits in domestic offices | 12,547 | 12,855 | 7,374 | 10,212 | 65,716 | 21,236 |
| Total domestic deposits | 16,757 | 17,030 | 7,761 | 13,101 | 80,883 | 28,641 |
| Total foreign deposits | 299 | 791 | 15 | 3,077 | 1,401 | 502 |
| Total deposits | 17,056 | 17,821 | 7,776 | 16,179 | 82,283 | 29,143 |
| Federal funds purchased and securities sold under agreements to repurchase | 1,893 | 3,090 | 4,764 | 2,194 | 8,172 | 4,925 |
| Demand notes issued to the U.S. Treasury | 68 | 550 | 4 | 198 | 708 | 17 |
| Other borrowed money | 109 | 680 | 9,839 | 166 | 1,352 | 1,036 |
| Subordinated notes and debentures | 28 | 154 | 196 | 133 | 270 | 152 |
| All other liabilities | 308 | 216 | 888 | 433 | 1,482 | 886 |
| *Total liabilities* | 19,462 | 22,511 | 23,467 | 19,303 | 94,267 | 36,159 |
| Limited-life preferred stock | 0 | 0 | 0 | 0 | 0 | 0 |
| **Equity capital** | | | | | | |
| Perpetual preferred stock | 0 | 10 | 13 | 0 | 0 | 0 |
| Common stock | 271 | 119 | 212 | 99 | 770 | 233 |
| Surplus | 614 | 419 | 507 | 224 | 2,805 | 882 |
| Net undivided profits and capital reserves | 535 | 443 | 941 | 803 | 2,449 | 1,490 |
| Cumulative foreign currency translation agreements | 0 | 0 | 0 | (3) | 0 | 0 |
| *Total equity capital* | 1,420 | 991 | 1,673 | 1,122 | 6,024 | 2,605 |
| *Total liabilities, limited-life preferred stock, and equity capital* | 20,882 | 23,502 | 25,140 | 20,425 | 100,291 | 38,764 |

## Assets, liabilities and capital accounts of national banks, by states, December 31, 1989
(Dollar amounts in millions) — continued

| | Hawaii | Idaho | Illinois | Indiana | Iowa | Kansas |
|---|---|---|---|---|---|---|
| Number of banks | 3 | 7 | 353 | 91 | 102 | 163 |
| **Assets** | | | | | | |
| Cash and balances due from depository institutions | | | | | | |
| Noninterest-bearing balances and currency and coin | $ 24 | $ 561 | $ 7,695 | $ 2,686 | $ 912 | $ 815 |
| Interest-bearing balances | 0 | 74 | 8,399 | 440 | 56 | 104 |
| Securities | 53 | 1,354 | 17,583 | 6,456 | 3,069 | [illegible] |
| Federal funds sold and securities purchased under agreements to resell | 17 | 161 | 8,602 | 1,669 | 596 | 913 |
| Loans and leases, net of unearned income | 166 | 4,281 | 67,077 | 20,113 | 5,733 | [illegible] |
| Less allowance for loan and lease losses | 2 | 68 | 1,651 | 246 | 100 | 93 |
| Less allocated transfer risk reserve | 0 | 0 | 0 | 0 | 0 | 0 |
| Net loans and leases | 164 | 4,213 | 65,425 | 19,867 | 5,632 | 5,872 |
| Premises and fixed assets | 5 | 85 | 1,261 | 372 | 144 | 173 |
| Other real estate owned | 0 | 6 | 286 | 41 | 23 | 47 |
| All other assets | 4 | 123 | 8,560 | 1,141 | 213 | 357 |
| *Total assets* | 267 | 6,577 | 117,810 | 32,673 | 10,646 | 11,813 |
| **Liabilities** | | | | | | |
| Deposits | | | | | | |
| Noninterest-bearing deposits in domestic offices | 67 | 896 | 15,168 | 5,077 | 1,845 | [illegible] |
| Interest-bearing deposits in domestic offices | 173 | 4,120 | 54,123 | 20,268 | 7,099 | 8,557 |
| Total domestic deposits | 240 | 5,016 | 69,291 | 25,345 | 8,945 | 10,080 |
| Total foreign deposits | 0 | 0 | 19,944 | 118 | 0 | 0 |
| Total deposits | 240 | 5,016 | 89,235 | 25,463 | 8,945 | 10,080 |
| Federal funds purchased and securities sold under agreements to repurchase | 2 | 940 | 9,398 | 3,392 | 688 | 555 |
| Demand notes issued to the U.S. Treasury | 2 | 125 | 1,291 | 418 | 58 | 65 |
| Other borrowed money | 0 | 1 | 4,603 | 253 | 8 | 6 |
| Subordinated notes and debentures | 2 | 9 | 509 | 7 | 16 | 2 |
| All other liabilities | 3 | 62 | 5,665 | 762 | 163 | 159 |
| *Total liabilities* | 249 | 6,153 | 110,700 | 30,296 | 9,877 | 10,867 |
| Limited-life preferred stock | 0 | 0 | 0 | 0 | 0 | 0 |
| **Equity capital** | | | | | | |
| Perpetual preferred stock | 0 | 0 | 10 | 0 | 12 | 0 |
| Common stock | 7 | 45 | 1,368 | 237 | 113 | 141 |
| Surplus | 6 | 196 | 3,173 | 637 | 176 | 247 |
| Net undivided profits and capital reserves | 5 | 183 | 2,569 | 1,504 | 468 | 558 |
| Cumulative foreign currency translation agreements | 0 | 0 | (10) | 0 | 0 | 0 |
| *Total equity capital* | 18 | 424 | 7,110 | 2,377 | 769 | 946 |
| *Total liabilities, limited-life preferred stock, and equity capital* | 267 | 6,577 | 117,810 | 32,673 | 10,646 | 11,813 |

## *Assets, liabilities and capital accounts of national banks, by states, December 31, 1989*
(Dollar amounts in millions) — continued

| | Kentucky | Louisiana | Maine | Maryland | Massachusetts | Michigan |
|---|---|---|---|---|---|---|
| Number of banks | 84 | 50 | 7 | 28 | 39 | 75 |
| **Assets** | | | | | | |
| Cash and balances due from depository institutions: | | | | | | |
| Noninterest-bearing balances and currency and coin | $ 1,244 | $ 1,712 | $ 242 | $ 1,853 | $ 3,989 | $ 3,512 |
| Interest-bearing balances | 258 | 480 | 3 | 331 | 4,410 | 2,366 |
| Securities | 3,279 | 5,739 | 314 | 4,310 | 4,590 | 11,618 |
| Federal funds sold and securities purchased under agreements to resell | 837 | 1,119 | 334 | 713 | 3,877 | 1,304 |
| Loans and leases, net of unearned income | 9,971 | 12,974 | 2,928 | 18,500 | 45,301 | 29,398 |
| Less allowance for loan and lease losses | 147 | 391 | 57 | 276 | 2,005 | 480 |
| Less allocated transfer risk reserve | 0 | 0 | 0 | 4 | 0 | 0 |
| Net loans and leases | 9,824 | 12,583 | 2,871 | 18,220 | 43,296 | 28,918 |
| Premises and fixed assets | 223 | 533 | 56 | 276 | 763 | 592 |
| Other real estate owned | 43 | 276 | 14 | 8 | 691 | 104 |
| All other assets | 281 | 543 | 97 | 1,479 | 3,649 | 1,614 |
| *Total assets* | 15,989 | 22,986 | 3,931 | 27,189 | 65,264 | 50,029 |
| Liabilities | | | | | | |
| Deposits | | | | | | |
| Noninterest-bearing deposits in domestic offices | 2,469 | 3,993 | 509 | 4,121 | 7,643 | 7,813 |
| Interest-bearing deposits in domestic offices | 10,143 | 15,339 | 2,873 | 14,342 | 29,200 | 29,921 |
| Total domestic deposits | 12,612 | 19,332 | 3,382 | 18,463 | 36,843 | 37,734 |
| Total foreign deposits | 283 | 269 | 0 | 662 | 10,300 | 2,258 |
| Total deposits | 12,895 | 19,600 | 3,382 | 19,125 | 47,143 | 39,992 |
| Federal funds purchased and securities sold under agreements to repurchase | 1,518 | 1,660 | 134 | 3,201 | 9,489 | 4,272 |
| Demand notes issued to the U.S. Treasury | 187 | 25 | 23 | 456 | 783 | 888 |
| Other borrowed money | 22 | 58 | 123 | 1,261 | 2,935 | 504 |
| Subordinated notes and debentures | 1 | 10 | 0 | 170 | 629 | 47 |
| All other liabilities | 221 | 274 | 33 | 1,150 | 1,696 | 1,214 |
| *Total liabilities* | 14,843 | 21,626 | 3,695 | 25,363 | 62,675 | 46,917 |
| Limited-life preferred stock | 0 | 0 | 0 | 76 | 0 | 0 |
| **Equity capital** | | | | | | |
| Perpetual preferred stock | 0 | 0 | 0 | 4 | 4 | 0 |
| Common stock | 109 | 121 | 30 | 116 | 175 | 369 |
| Surplus | 190 | 636 | 58 | 553 | 1,216 | 889 |
| Net undivided profits and capital reserves | 847 | 603 | 147 | 1,078 | 1,193 | 1,846 |
| Cumulative foreign currency translation agreements | 0 | 0 | 0 | 0 | 2 | 7 |
| *Total equity capital* | 1,145 | 1,359 | 236 | 1,750 | 2,589 | 3,111 |
| *Total liabilities, limited-life preferred stock, and equity capital* | 15,989 | 22,986 | 3,931 | 27,189 | 65,264 | 50,029 |

## Assets, liabilities and capital accounts of national banks, by states, December 31, 1989
(Dollar amounts in millions) — continued

| | Minnesota | Mississippi | Missouri | Montana | Nebraska | Nevada |
|---|---|---|---|---|---|---|
| Number of banks | 157 | 27 | 93 | 56 | 111 | 7 |
| **Assets** | | | | | | |
| Cash and balances due from depository institutions | | | | | | |
| Noninterest-bearing balances and currency and coin | $ 2,496 | $ 683 | $ 3,271 | $ 217 | $ 959 | $ 486 |
| Interest-bearing balances | 271 | 95 | 268 | 40 | 90 | 4 |
| Securities | 6,640 | 2,367 | 5,512 | 792 | 2,766 | 1,243 |
| Federal funds sold and securities purchased under agreements to resell | 1,574 | 534 | 2,183 | 785 | 612 | 66 |
| Loans and leases, net of unearned income | 23,245 | 5,382 | 17,553 | 1,817 | 6,091 | 11,045 |
| Less allowance for loan and lease losses | 471 | 80 | 313 | 41 | 106 | 166 |
| Less allocated transfer risk reserve | 0 | 0 | 0 | 0 | 0 | 0 |
| Net loans and leases | 22,774 | 5,302 | 17,240 | 1,776 | 5,984 | 10,879 |
| Premises and fixed assets | 319 | 184 | 537 | 59 | 186 | 133 |
| Other real estate owned | 73 | 35 | 84 | 12 | 30 | 47 |
| All other assets | 1,304 | 216 | 657 | 64 | 260 | 421 |
| *Total assets* | 35,451 | 9,416 | 29,752 | 3,745 | 10,888 | 13,279 |
| **Liabilities** | | | | | | |
| Deposits: | | | | | | |
| Noninterest-bearing deposits in domestic offices | 5,692 | 1,406 | 5,972 | 526 | 1,724 | 1,119 |
| Interest-bearing deposits in domestic offices | 20,871 | 6,417 | 16,891 | 2,710 | 7,523 | 3,600 |
| Total domestic deposits | 26,563 | 7,823 | 22,863 | 3,236 | 9,247 | 4,719 |
| Total foreign deposits | 500 | 0 | 103 | 0 | 0 | 0 |
| Total deposits | 27,064 | 7,823 | 22,965 | 3,236 | 9,247 | 4,719 |
| Federal funds purchased and securities sold under agreements to repurchase | 4,645 | 720 | 3,741 | 168 | 500 | 1,140 |
| Demand notes issued to the U.S. Treasury | 122 | 6 | 280 | 1 | 32 | 18 |
| Other borrowed money | 317 | 33 | 332 | 14 | 88 | 5,952 |
| Subordinated notes and debentures | 236 | 1 | 0 | 14 | 8 | 150 |
| All other liabilities | 1,082 | 118 | 405 | 67 | 181 | 494 |
| *Total liabilities* | 33,466 | 8,701 | 27,724 | 3,502 | 10,055 | 12,474 |
| Limited-life preferred stock | 0 | 0 | 0 | 0 | 0 | 0 |
| **Equity capital** | | | | | | |
| Perpetual preferred stock | 0 | 0 | 3 | 6 | 1 | 0 |
| Common stock | 382 | 49 | 240 | 88 | 123 | 133 |
| Surplus | 753 | 532 | 534 | 111 | 176 | 168 |
| Net undivided profits and capital reserves | 849 | 133 | 1,252 | 37 | 532 | 504 |
| Cumulative foreign currency translation agreements | 0 | 0 | 0 | 0 | 0 | 0 |
| *Total equity capital* | 1,984 | 715 | 2,027 | 242 | 832 | 805 |
| *Total liabilities, limited-life preferred stock, and equity capital* | 35,451 | 9,416 | 29,752 | 3,745 | 10,888 | 13,279 |

## Assets, liabilities and capital accounts of national banks, by states, December 31, 1989
(Dollar amounts in millions) — continued

| | New Hampshire | New Jersey | New Mexico | New York | North Carolina | North Dakota |
|---|---|---|---|---|---|---|
| Number of banks | 14 | 56 | 41 | 95 | 17 | 30 |
| **Assets** | | | | | | |
| Cash and balances due from depository institutions: | | | | | | |
| Noninterest-bearing balances and currency and coin | $ 259 | $ 4,707 | $ 415 | $ 19,187 | $ 3,987 | $ 205 |
| Interest-bearing balances | 7 | 344 | 35 | 27,157 | 1,212 | 54 |
| Securities | 545 | 11,436 | 1,644 | 29,713 | 11,572 | 882 |
| Federal funds sold and securities purchased under agreements to resell | 135 | 1,219 | 682 | 8,482 | 2,376 | 325 |
| Loans and leases, net of unearned income | 3,336 | 47,833 | 3,601 | 220,466 | 36,518 | 1,566 |
| Less allowance for loan and lease losses | 50 | 799 | 57 | 8,564 | 395 | 32 |
| Less allocated transfer risk reserve | 0 | 0 | 0 | 0 | 0 | 0 |
| Net loans and leases | 3,286 | 47,034 | 3,543 | 211,902 | 36,123 | 1,534 |
| Premises and fixed assets | 50 | 931 | 118 | 4,443 | 840 | 42 |
| Other real estate owned | 12 | 226 | 74 | 583 | 46 | 7 |
| All other assets | 94 | 1,760 | 125 | 35,525 | 2,600 | 53 |
| *Total assets* | 4,388 | 67,657 | 6,637 | 336,991 | 58,755 | 3,102 |
| Liabilities | | | | | | |
| Deposits | | | | | | |
| Noninterest-bearing deposits in domestic offices | 561 | 12,458 | 889 | 36,777 | 7,135 | 374 |
| Interest-bearing deposits in domestic offices | 3,158 | 43,107 | 4,478 | 95,735 | 29,320 | 2,399 |
| Total domestic deposits | 3,719 | 55,565 | 5,367 | 132,511 | 36,455 | 2,773 |
| Total foreign deposits | 0 | 158 | 0 | 113,356 | 1,489 | 0 |
| Total deposits | 3,719 | 55,723 | 5,367 | 245,867 | 37,944 | 2,773 |
| Federal funds purchased and securities sold under agreements to repurchase | 266 | 5,524 | 674 | 19,515 | 14,207 | 47 |
| Demand notes issued to the U.S. Treasury | 34 | 254 | 43 | 2,191 | 669 | 6 |
| Other borrowed money | 27 | 515 | 1 | 23,559 | 901 | 0 |
| Subordinated notes and debentures | 0 | 278 | 5 | 1,589 | 108 | 13 |
| All other liabilities | 53 | 1,184 | 64 | 27,609 | 1,492 | [illegible] |
| *Total liabilities* | 4,100 | 63,478 | 6,155 | 320,332 | 55,322 | 2,899 |
| Limited-life preferred stock | 0 | 0 | 0 | 0 | 0 | [illegible] |
| Equity capital | | | | | | |
| Perpetual preferred stock | 0 | 5 | 0 | 106 | 0 | [illegible] |
| Common stock | 22 | 631 | 96 | 2,473 | 351 | 54 |
| Surplus | 48 | 854 | 136 | 8,310 | 729 | [illegible] |
| Net undivided profits and capital reserves | 218 | 2,690 | 250 | 6,027 | 2,357 | 79 |
| Cumulative foreign currency translation agreements | 0 | 0 | 0 | (256) | (3) | [illegible] |
| *Total equity capital* | 288 | 4,179 | 482 | 16,660 | 3,433 | [illegible] |
| *Total liabilities, limited-life preferred stock, and equity capital* | 4,388 | 67,657 | 6,637 | 336,991 | 58,755 | [illegible] |

## Assets, liabilities and capital accounts of national banks, by states, December 31, 1989
(Dollar amounts in millions) — continued

| | Ohio | Oklahoma | Oregon | Pennsylvania | Puerto Rico | Rhode Island |
|---|---|---|---|---|---|---|
| Number of banks | 135 | 177 | 7 | 163 | 1 | [illegible] |
| **Assets** | | | | | | |
| Cash and balances due from depository institutions | | | | | | |
| Noninterest bearing balances and currency and coin | $ 6,008 | $ 1,300 | $ 1,412 | $ 7,670 | $ 4 | $ 598 |
| Interest-bearing balances | 2,340 | 276 | 248 | 4,401 | 2 | 201 |
| Securities | 15,903 | 5,057 | 2,917 | 21,916 | 14 | 2 288 |
| Federal funds sold and securities purchased under agreements to resell | 2,885 | 1,002 | 209 | 2,338 | 5 | 1 437 |
| Loans and leases, net of unearned income | 53,858 | 7,025 | 11,200 | 70,972 | 53 | 9 680 |
| Less allowance for loan and lease losses | 802 | 205 | 157 | 1,647 | 2 | 206 |
| Less allocated transfer risk reserve | 0 | 0 | 0 | 0 | 0 | 0 |
| Net loans and leases | 53,056 | 6,821 | 11,042 | 69,326 | 52 | 9 475 |
| Premises and fixed assets | 975 | 274 | 192 | 1,287 | 3 | 111 |
| Other real estate owned | 83 | 286 | 19 | 166 | 0 | 137 |
| All other assets | 2,491 | 389 | 853 | 5,756 | 2 | 488 |
| *Total assets* | 83,741 | 15,406 | 16,892 | 112,859 | 80 | 14,734 |
| **Liabilities** | | | | | | |
| Deposits | | | | | | |
| Noninterest-bearing deposits in domestic offices | 11,330 | 2,772 | 2,451 | 15 904 | 11 | 1 194 |
| Interest-bearing deposits in domestic offices | 51,482 | 10,430 | 9,899 | 60,280 | 58 | 7 980 |
| Total domestic deposits | 62,812 | 13,202 | 12,350 | 76,184 | 68 | 9,174 |
| Total foreign deposits | 2,009 | 44 | 0 | 6,992 | 0 | 1,101 |
| Total deposits | 64,821 | 13,246 | 12,350 | 83,176 | 68 | 10 275 |
| Federal funds purchased and securities sold under agreements to repurchase | 10,103 | 631 | 1,888 | 14,137 | 9 | 1 308 |
| Demand notes issued to the U.S. Treasury | 336 | 169 | 126 | 1,337 | 0 | 99 |
| Other borrowed money | 751 | 36 | 722 | 2,626 | 0 | 1,709 |
| Subordinated notes and debentures | 563 | 4 | 17 | 1,121 | 0 | 90 |
| All other liabilities | 1,592 | 205 | 642 | 4,262 | 1 | 346 |
| *Total liabilities* | 78,167 | 14,291 | 15,744 | 106,659 | 78 | 13 827 |
| Limited-life preferred stock | 2 | 0 | 0 | 0 | 0 | 0 |
| **Equity capital** | | | | | | |
| Perpetual preferred stock | 5 | 163 | 2 | 0 | 0 | 20 |
| Common stock | 739 | 208 | 96 | 652 | 2 | 43 |
| Surplus | 1 616 | 348 | 228 | 1,888 | 4 | 333 |
| Net undivided profits and capital reserves | 3,212 | 394 | 822 | 3 656 | (4) | 512 |
| Cumulative foreign currency translation agreements | 0 | 0 | 0 | 3 | 0 | 0 |
| *Total equity capital* | 5,572 | 1,113 | 1,148 | 6,200 | 2 | 908 |
| *Total liabilities, limited-life preferred stock, and equity capital* | 83,741 | 15,406 | 16,892 | 112,859 | 80 | 14 734 |

## *Assets, liabilities and capital accounts of national banks, by states, December 31, 1989*
(Dollar amounts in millions) — continued

| | South Carolina | South Dakota | Tennessee | Texas | Utah | Vermont |
|---|---|---|---|---|---|---|
| Number of banks | 29 | 24 | 50 | 687 | 6 | 12 |
| **Assets** | | | | | | |
| Cash and balances due from depository institutions: | | | | | | |
| Noninterest-bearing balances and currency and coin | $ 1,315 | $ 343 | $ 1,737 | $ 10,230 | $ 628 | $ 117 |
| Interest-bearing balances | 32 | 32 | 748 | 4,574 | 164 | 28 |
| Securities | 4,092 | 1,020 | 5,158 | 26,909 | 1,262 | 276 |
| Federal funds sold and securities purchased under agreements to resell | 690 | 183 | 591 | 14,970 | 129 | 83 |
| Loans and leases, net of unearned income | 12,653 | 13,189 | 14,746 | 63,456 | 4,432 | 1,793 |
| Less allowance for loan and lease losses | 156 | 253 | 293 | 2,173 | 98 | 17 |
| Less allocated transfer risk reserve | 0 | 0 | 0 | 0 | 0 | 0 |
| Net loans and leases | 12,497 | 12,936 | 14,453 | 61,283 | 4,334 | 1,776 |
| Premises and fixed assets | 250 | 133 | 318 | 2,628 | 83 | 38 |
| Other real estate owned | 23 | 7 | 81 | 2,898 | 40 | 2 |
| All other assets | 451 | 1,200 | 772 | 9,690 | 378 | 39 |
| *Total assets* | 19,349 | 15,854 | 23,858 | 133,181 | 7,017 | 2,360 |
| **Liabilities** | | | | | | |
| Deposits | | | | | | |
| Noninterest-bearing deposits in domestic offices | 2,662 | 588 | 3,644 | 21,708 | 1,116 | 276 |
| Interest-bearing deposits in domestic offices | 10,969 | 5,394 | 15,386 | 82,384 | 4,217 | 1,828 |
| Total domestic deposits | 13,631 | 5,983 | 19,031 | 104,092 | 5,332 | 2,104 |
| Total foreign deposits | 0 | 0 | 39 | 3,155 | 93 | 0 |
| Total deposits | 13,631 | 5,983 | 19,070 | 107,247 | 5,425 | 2,104 |
| Federal funds purchased and securities sold under agreements to repurchase | 3,908 | 1,501 | 2,438 | 12,902 | 1,001 | 50 |
| Demand notes issued to the U.S. Treasury | 107 | 4 | 64 | 1,486 | 24 | 19 |
| Other borrowed money | 121 | 5,443 | 182 | 3,261 | 5 | 3 |
| Subordinated notes and debentures | 55 | 436 | 137 | 367 | 18 | 0 |
| All other liabilities | 284 | 1,364 | 428 | 2,761 | 125 | 23 |
| *Total liabilities* | 18,106 | 14,732 | 22,319 | 128,024 | 6,598 | 2,199 |
| Limited-life preferred stock | 0 | 0 | 0 | 0 | 0 | 0 |
| **Equity capital** | | | | | | |
| Perpetual preferred stock | 0 | 1 | 1 | 52 | 0 | [illegible] |
| Common stock | 135 | 176 | 211 | 1,677 | 53 | [illegible] |
| Surplus | 477 | 275 | 403 | 4,045 | 128 | [illegible] |
| Net undivided profits and capital reserves | 631 | 671 | 923 | (619) | 238 | [illegible] |
| Cumulative foreign currency translation agreements | 0 | 0 | 0 | (0) | 0 | [illegible] |
| *Total equity capital* | 1,244 | 1,122 | 1,539 | 5,156 | 419 | [illegible] |
| *Total liabilities, limited-life preferred stock, and equity capital* | 19,349 | 15,854 | 23,858 | 133,181 | 7,017 | [illegible] |

## Assets, liabilities and capital accounts of national banks, by states, December 31, 1989
(Dollar amounts in millions) — continued

| | Virginia | Washington | West Virginia | Wisconsin | Wyoming |
|---|---|---|---|---|---|
| Number of banks | 52 | 27 | 84 | 110 | 32 |
| **Assets** | | | | | |
| Cash and balances due from depository institutions | | | | | |
| Noninterest-bearing balances and currency and coin | $ 1,826 | $ 2,978 | $ 413 | $ 1,630 | $ 122 |
| Interest-bearing balances | 402 | 284 | 116 | 140 | 45 |
| Securities | 4,858 | 2,272 | 3,166 | 3,636 | 909 |
| Federal funds sold and securities purchased under agreements to resell | 687 | 610 | 513 | 707 | 192 |
| Loans and leases, net of unearned income | 18,825 | 25,072 | 5,396 | 12,201 | 772 |
| Less allowance for loan and lease losses | 207 | 363 | 68 | 172 | 23 |
| Less allocated transfer risk reserve | 0 | 0 | 0 | 0 | 0 |
| Net loans and leases | 18,617 | 24,710 | 5,328 | 12,029 | 749 |
| Premises and fixed assets | 543 | 931 | 191 | 278 | 29 |
| Other real estate owned | 32 | 111 | 32 | 52 | 11 |
| All other assets | 1,119 | 1,120 | 158 | 475 | 44 |
| *Total assets* | 28,086 | 33,014 | 9,917 | 18,948 | 2,101 |
| **Liabilities** | | | | | |
| Deposits: | | | | | |
| Noninterest-bearing deposits in domestic offices | 3,829 | 5,961 | 1,122 | 3,235 | 300 |
| Interest-bearing deposits in domestic offices | 17,397 | 20,161 | 7,201 | 12,001 | 1,570 |
| Total domestic deposits | 21,226 | 26,122 | 8,323 | 15,236 | 1,871 |
| Total foreign deposits | 82 | 540 | 0 | 26 | 0 |
| Total deposits | 21,308 | 26,662 | 8,323 | 15,262 | 1,871 |
| Federal funds purchased and securities sold under agreements to repurchase | 3,929 | 2,510 | 576 | 1,706 | 31 |
| Demand notes issued to the U.S. Treasury | 374 | 249 | 18 | 137 | 2 |
| Other borrowed money * | 193 | 261 | 1 | 34 | 1 |
| Subordinated notes and debentures | 31 | 304 | 1 | 46 | 1 |
| All other liabilities | 360 | 910 | 110 | 401 | 20 |
| *Total liabilities* | 26,195 | 30,896 | 9,028 | 17,586 | 1,925 |
| Limited-life preferred stock | 0 | 0 | 0 | 0 | 0 |
| **Equity capital** | | | | | |
| Perpetual preferred stock | 0 | 0 | 0 | 0 | 0 |
| Common stock | 136 | 231 | 93 | 182 | 15 |
| Surplus | 394 | 1,071 | 236 | 408 | 55 |
| Net undivided profits and capital reserves | 1,361 | 816 | 559 | 771 | 106 |
| Cumulative foreign currency translation agreements | 0 | 1 | 0 | 0 | 0 |
| *Total equity capital* | 1,891 | 2,119 | 888 | 1,361 | 176 |
| *Total liabilities, limited-life preferred stock, and equity capital* | 28,086 | 33,014 | 9,917 | 18,948 | 2,101 |

## *Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989*
(Dollar amounts in millions)

| | *Total United States* | *Alabama* | *Alaska* | *Arizona* | *Arkansas* | *California* |
|---|---|---|---|---|---|---|
| Number of banks | 4,163 | 50 | 4 | 14 | 81 | 163 |
| Interest income: | | | | | | |
| Interest and fee income on loans | $147,142 | $ 1,084 | $ 146 | $ 1,305 | $ 575 | $ 17,492 |
| Income from lease financing receivables | 3,146 | 6 | 1 | 32 | 2 | 353 |
| Interest income on balances due from depository institutions | 8,675 | 10 | 8 | 17 | 7 | 579 |
| Interest and dividend income on securities | 24,765 | 341 | 106 | 205 | 232 | 1,291 |
| Interest income from assets held in trading accounts | 2,426 | 16 | 0 | 7 | 4 | 301 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 7,440 | 31 | 16 | 39 | 52 | 668 |
| *Total interest income* | 193,594 | 1,487 | 278 | 1,606 | 872 | 20,683 |
| Interest expense: | | | | | | |
| Interest on deposits | 93,370 | 781 | 121 | 775 | 468 | 9,188 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 16,595 | 164 | 28 | 66 | 22 | 1,375 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 15,605 | 7 | 2 | 37 | 4 | 1,037 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 146 | 0[1] | 0 | 1 | 1 | 23 |
| Interest on notes and debentures subordinated to deposits | 980 | 0 | 0 | 2 | 1 | 319 |
| *Total interest expense* | 126,695 | 953 | 150 | 881 | 496 | 11,942 |
| Net interest income | 66,899 | 535 | 127 | 725 | 376 | 8,741 |
| Provision for loan and lease losses | 17,672 | 61 | 18 | 773 | 40 | 1,278 |
| Provision for allocated transfer risk | 42 | 0 | 0 | 0 | 0 | 36 |
| Noninterest income: | | | | | | |
| Service charges on deposit accounts | 6,407 | 65 | 15 | 117 | 44 | 1,073 |
| Other noninterest income | 26,254 | 121 | 39 | 181 | 88 | 3,807 |
| *Total noninterest income* | 32,661 | 187 | 53 | 298 | 131 | 4,879 |
| Gains and losses on securities not held in trading accounts | 462 | 6 | 0 | 7 | 2 | (11) |
| Noninterest expense: | | | | | | |
| Salaries and employee benefits | 29,039 | 225 | 55 | 369 | 163 | 3,733 |
| Expenses of premises and fixed assets (net of rental income) | 10,121 | 69 | 20 | 124 | 52 | 1,461 |
| Other noninterest expense | 26,836 | 167 | 34 | 281 | 136 | 3,253 |
| *Total noninterest expense* | 65,995 | 461 | 109 | 773 | 351 | 8,446 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 16,312 | 206 | 54 | (517) | 117 | 3,850 |
| Applicable income taxes | 5,856 | 44 | 10 | (221) | 26 | 1,494 |
| Income before extraordinary items and other adjustments | 10,457 | 162 | 43 | (296) | 91 | 2,355 |
| Extraordinary items and other adjustments, net of taxes | 312 | 0 | 0 | 0 | 1 | 325 |
| Net income | 10,769 | 162 | 44 | (296) | 92 | 2,680 |
| Total cash dividends declared | 7,955 | 91 | 6 | 39 | 48 | 791 |
| Recoveries credited to allowance for possible loan losses | 2,685 | 16 | 2 | 32 | 17 | 574 |
| Losses charged to allowance for possible loan losses | 17,550 | 55 | 16 | 520 | 53 | 2,256 |
| Net loan losses | 14,865 | 40 | 14 | 488 | 36 | 1,682 |

[1] Zeros indicate amounts of less than $500,000.

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989 — Continued
(Dollar amounts in millions)

| | Colorado | Connecticut | Delaware | District of Columbia | Florida | Georgia |
|---|---|---|---|---|---|---|
| Number of banks | 255 | 17 | 15 | 24 | 168 | 65 |
| Interest income | | | | | | |
| Interest and fee income on loans | $ 1,298 | $ 1,745 | $ 3,221 | $ 1,379 | $ 6,734 | $ 2,927 |
| Income from lease financing receivables | 11 | 0 | 8 | 6 | 32 | 48 |
| Interest income on balances due from depository institutions | 86 | 1 | 10 | 167 | 175 | 77 |
| Interest and dividend income on securities | 307 | 311 | 23 | 212 | 1,326 | 566 |
| Interest income from assets held in trading accounts | 3 | 1 | 30 | 5 | 5 | 7 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 126 | 145 | 9 | 38 | 465 | 92 |
| *Total interest income* | 1,830 | 2,203 | 3,302 | 1,807 | 8,737 | 3,717 |
| Interest expense: | | | | | | |
| Interest on deposits | 877 | 963 | 611 | 987 | 4,406 | 1,638 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 148 | 423 | 321 | 172 | 725 | 464 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 11 | 60 | 805 | 18 | 87 | 35 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 4 | 2 | 0 | 1 | 6 | 2 |
| Interest on notes and debentures subordinated to deposits | 3 | 15 | 9 | 16 | 24 | 20 |
| *Total interest expense* | 1,042 | 1,462 | 1,746 | 1,194 | 5,249 | 2,159 |
| Net interest income | 788 | 741 | 1,556 | 613 | 3,488 | 1,558 |
| Provision for loan and lease losses | 169 | 537 | 720 | 53 | 680 | 179 |
| Provision for allocated transfer risk | 0 | 0 | 0 | 0 | 1 | 0 |
| Noninterest income: | | | | | | |
| Service charges on deposit accounts | 119 | 84 | 7 | 54 | 438 | 219 |
| Other noninterest income | 300 | 205 | 873 | 167 | 749 | 311 |
| *Total noninterest income* | 419 | 289 | 880 | 221 | 1,187 | 529 |
| Gains and losses on securities not held in trading accounts | 3 | 18 | 0 | 9 | 48 | 13 |
| Noninterest expense: | | | | | | |
| Salaries and employee benefits | 352 | 365 | 230 | 243 | 1,424 | 658 |
| Expenses of premises and fixed assets (net of rental income) | 129 | 135 | 67 | 104 | 586 | 212 |
| Other noninterest expense | 455 | 291 | 877 | 237 | 1,264 | 581 |
| *Total noninterest expense* | 936 | 791 | 1,174 | 584 | 3,274 | 1,451 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 105 | (281) | 542 | 206 | 768 | 471 |
| Applicable income taxes | 30 | 19 | 198 | 58 | 211 | 100 |
| Income before extraordinary items and other adjustments | 75 | (300) | 344 | 148 | 557 | 371 |
| Extraordinary items and other adjustments, net of taxes | 1 | 0 | (2) | 0 | 2 | 0 |
| Net income | 76 | (300) | 342 | 148 | 559 | 371 |
| Total cash dividends declared | 50 | 76 | 114 | 63 | 465 | 165 |
| Recoveries credited to allowance for possible loan losses | 34 | 11 | 111 | 14 | 85 | 51 |
| Losses charged to allowance for possible loan losses | 233 | 215 | 713 | 72 | 525 | 225 |
| Net loan losses | 200 | 204 | 602 | 58 | 441 | 174 |

## *Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989 — Continued*

(Dollar amounts in millions)

| | *Hawaii* | *Idaho* | *Illinois* | *Indiana* | *Iowa* | *Kansas* |
|---|---|---|---|---|---|---|
| Number of banks | 3 | 7 | 353 | 91 | 102 | 163 |
| Interest income: | | | | | | |
| Interest and fee income on loans | $ 17 | $ 467 | $ 7,333 | $ 2,162 | $ 621 | $ 670 |
| Income from lease financing receivables | 0 | 8 | 14 | 35 | 0 | 4 |
| Interest income on balances due from depository institutions | 0 | 7 | 1,054 | 53 | 5 | 10 |
| Interest and dividend income on securities | 5 | 95 | 1,465 | 544 | 251 | 304 |
| Interest income from assets held in trading accounts | 0 | 0 | 251 | 2 | 0 | 1 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 1 | 19 | 729 | 98 | 48 | 74 |
| *Total interest income* | 23 | 595 | 10,846 | 2,894 | 926 | 1,063 |
| Interest expense: | | | | | | |
| Interest on deposits | 10 | 280 | 6,173 | 1,443 | 475 | 571 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 0 | 59 | 985 | 305 | 60 | 44 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 0 | 7 | 453 | 44 | 4 | 6 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 0 | 0 | 2 | 2 | 1 | 1 |
| Interest on notes and debentures subordinated to deposits | 0 | 1 | 46 | 1 | 1 | 0 |
| *Total interest expense* | 11 | 347 | 7,658 | 1,796 | 542 | 622 |
| Net interest income | 12 | 248 | 3,187 | 1,099 | 383 | 441 |
| Provision for loan and lease losses | 0 | 16 | 422 | 127 | 28 | 35 |
| Provision for allocated transfer risk | 0 | 0 | 0 | 0 | 0 | 0 |
| Noninterest income: | | | | | | |
| Service charges on deposit accounts | 1 | 31 | 247 | 99 | 36 | 44 |
| Other noninterest income | 2 | 38 | 1,213 | 256 | 79 | 79 |
| *Total noninterest income* | 3 | 69 | 1,460 | 356 | 115 | 123 |
| Gains and losses on securities not held in trading accounts | 0 | (0) | 14 | (3) | (1) | (0) |
| Noninterest expense: | | | | | | |
| Salaries and employee benefits | 6 | 82 | 1,536 | 396 | 151 | 167 |
| Expenses of premises and fixed assets (net of rental income) | 3 | 17 | 449 | 121 | 44 | 44 |
| Other noninterest expense | 4 | 98 | 931 | 388 | 124 | 149 |
| *Total noninterest expense* | 14 | 197 | 2,916 | 905 | 319 | 361 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 1 | 105 | 1,325 | 420 | 150 | 168 |
| Applicable income taxes | 1 | 33 | 202 | 100 | 44 | 45 |
| Income before extraordinary items and other adjustments | 0 | 72 | 1,123 | 319 | 106 | 123 |
| Extraordinary items and other adjustments, net of taxes | 0 | 0 | (135) | 3 | 1 | 3 |
| Net income | 0 | 72 | 988 | 323 | 108 | 126 |
| Total cash dividends declared | 0 | 60 | 520 | 157 | 37 | 52 |
| Recoveries credited to allowance for possible loan losses | 0 | 12 | 111 | 32 | 14 | 13 |
| Losses charged to allowance for possible loan losses | 0 | 26 | 1,411 | 170 | 41 | 49 |
| Net loan losses | (0) | 14 | 1,300 | 138 | 27 | 36 |

*Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989 — Continued*
(Dollar amounts in millions)

| | Kentucky | Louisiana | Maine | Maryland | Massachusetts | Michigan |
|---|---|---|---|---|---|---|
| Number of banks | 84 | 50 | 7 | 28 | 39 | 75 |
| Interest income | | | | | | |
| Interest and fee income on loans | $ 1,066 | $ 1,425 | $ 340 | $ 2,004 | $ 5,999 | $ 3,218 |
| Income from lease financing receivables | 16 | 2 | 0 | 49 | 414 | 37 |
| Interest income on balances due from depository institutions | 18 | 39 | 1 | 29 | 882 | 259 |
| Interest and dividend income on securities | 260 | 470 | 30 | 367 | 902 | 847 |
| Interest income from assets held in trading accounts | 1 | 0 | 0 | 36 | 62 | 7 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 62 | 85 | 11 | 59 | 188 | 134 |
| *Total interest income* | 1,422 | 2,021 | 381 | 2,544 | 8,448 | 4,501 |
| Interest expense | | | | | | |
| Interest on deposits | 730 | 1,087 | 208 | 1,114 | 4,156 | 2,433 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 138 | 167 | 8 | 276 | 1,113 | 296 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 19 | 5 | 13 | 112 | 1,220 | 90 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 2 | 1 | 0 | 2 | 5 | 2 |
| Interest on notes and debentures subordinated to deposits | 0 | 1 | 0 | 18 | 34 | 13 |
| *Total interest expense* | 888 | 1,261 | 230 | 1,521 | 6,529 | 2,835 |
| Net interest income | 535 | 760 | 151 | 1,023 | 1,919 | 1,666 |
| Provision for loan and lease losses | 65 | 365 | 45 | 128 | 1,762 | 225 |
| Provision for allocated transfer risk | 0 | 0 | 0 | 0 | 0 | 0 |
| Noninterest income | | | | | | |
| Service charges on deposit accounts | 51 | 94 | 11 | 110 | 131 | 161 |
| Other noninterest income | 93 | 154 | 42 | 257 | 969 | 613 |
| *Total noninterest income* | 145 | 248 | 53 | 368 | 1,100 | 774 |
| Gains and losses on securities not held in trading accounts | (1) | 3 | 0 | (3) | 70 | (15) |
| Noninterest expense | | | | | | |
| Salaries and employee benefits | 211 | 307 | 59 | 466 | 954 | 729 |
| Expenses of premises and fixed assets (net of rental income) | 68 | 103 | 21 | 141 | 357 | 213 |
| Other noninterest expense | 142 | 346 | 47 | 355 | 833 | 555 |
| *Total noninterest expense* | 421 | 756 | 128 | 962 | 2,144 | 1,497 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 192 | (110) | 32 | 298 | (817) | 704 |
| Applicable income taxes | 36 | (21) | 13 | 82 | (175) | 171 |
| Income before extraordinary items and other adjustments | 156 | (89) | 19 | 216 | (642) | 533 |
| Extraordinary items and other adjustments, net of taxes | 1 | 0 | 0 | 2 | 0 | 5 |
| Net income | 156 | (88) | 19 | 219 | (642) | 538 |
| Total cash dividends declared | 69 | 72 | 12 | 53 | 127 | 322 |
| Recoveries credited to allowance for possible loan losses | 13 | 40 | 2 | 33 | 105 | 41 |
| Losses charged to allowance for possible loan losses | 68 | 272 | 23 | 162 | 801 | 208 |
| Net loan losses | 55 | 232 | 21 | 129 | 696 | 167 |

## *Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989 — Continued*

(Dollar amounts in millions)

| | *Minnesota* | *Mississippi* | *Missouri* | *Montana* | *Nebraska* | *Nevada* |
|---|---|---|---|---|---|---|
| Number of banks | 157 | 27 | 93 | 56 | 111 | 7 |
| Interest income: | | | | | | |
| Interest and fee income on loans | $ 2,553 | $ 584 | $ 1,819 | $ 204 | $ 707 | $ 1,543 |
| Income from lease financing receivables | 20 | 0 | 12 | 0 | 6 | 0 |
| Interest income on balances due from depository institutions | 35 | 8 | 15 | 4 | 7 | 0 |
| Interest and dividend income on securities | 550 | 191 | 437 | 70 | 243 | 110 |
| Interest income from assets held in trading accounts | 19 | 0 | 7 | 0 | 2 | 0 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 167 | 59 | 178 | 69 | 46 | 5 |
| *Total interest income* | 3,345 | 843 | 2,467 | 347 | 1,010 | 1,659 |
| Interest expense: | | | | | | |
| Interest on deposits | 1,697 | 464 | 1,225 | 178 | 510 | 203 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 404 | 57 | 277 | 15 | 39 | 120 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 72 | 2 | 27 | 2 | 11 | 396 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 3 | 0 | 7 | 1 | 3 | 0 |
| Interest on notes and debentures subordinated to deposits | 26 | 0 | 0 | 1 | 1 | 15 |
| *Total interest expense* | 2,202 | 524 | 1,536 | 197 | 563 | 734 |
| Net interest income | 1,143 | 320 | 931 | 150 | 447 | 925 |
| Provision for loan and lease losses | 306 | 33 | 158 | 7 | 47 | 218 |
| Provision for allocated transfer risk | 0 | 0 | 0 | 0 | 0 | 0 |
| Noninterest income: | | | | | | |
| Service charges on deposit accounts | 121 | 42 | 105 | 13 | 33 | 32 |
| Other noninterest income | 394 | 56 | 307 | 28 | 198 | 209 |
| *Total noninterest income* | 515 | 98 | 412 | 41 | 231 | 242 |
| Gains and losses on securities not held in trading accounts | 9 | (1) | 0 | (0) | (1) | 0 |
| Noninterest expense: | | | | | | |
| Salaries and employee benefits | 426 | 146 | 413 | 49 | 166 | 111 |
| Expenses of premises and fixed assets (net of rental income) | 130 | 49 | 136 | 16 | 56 | 45 |
| Other noninterest expense | 630 | 88 | 364 | 70 | 237 | 386 |
| *Total noninterest expense* | 1,185 | 284 | 913 | 136 | 458 | 543 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 175 | 99 | 272 | 48 | 172 | 407 |
| Applicable income taxes | 70 | 17 | 63 | 12 | 44 | 168 |
| Income before extraordinary items and other adjustments | 105 | 82 | 209 | 36 | 127 | 238 |
| Extraordinary items and other adjustments, net of taxes | 1 | 0 | 3 | 0 | 1 | 25 |
| Net income | 106 | 82 | 212 | 37 | 128 | 264 |
| Total cash dividends declared | 214 | 28 | 139 | 15 | 70 | 35 |
| Recoveries credited to allowance for possible loan losses | 54 | 11 | 33 | 12 | 30 | 22 |
| Losses charged to allowance for possible loan losses | 426 | 41 | 173 | 22 | 78 | 268 |
| Net loan losses | 372 | 30 | 139 | 10 | 47 | 246 |

## Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989 — Continued
(Dollar amounts in millions)

| | New Hampshire | New Jersey | New Mexico | New York | North Carolina | [illegible] |
|---|---|---|---|---|---|---|
| Number of banks | 14 | 56 | 41 | 95 | 17 | 30 |
| Interest income | | | | | | |
| Interest and fee income on loans | $ 384 | $ 5,099 | $ 418 | $ 31,492 | $ 3,772 | $ [illegible] |
| Income from lease financing receivables | 1 | 32 | 2 | 1,294 | 98 | 1 |
| Interest income on balances due from depository institutions | 1 | 40 | 3 | 3,631 | 119 | 6 |
| Interest and dividend income on securities | 45 | 857 | 134 | 2,804 | 901 | 73 |
| Interest income from assets held in trading accounts | 0 | 8 | 0 | 1,401 | 99 | 0 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 7 | 96 | 59 | 968 | 229 | 27 |
| *Total interest income* | 438 | 6,132 | 616 | 41,591 | 5,219 | 284 |
| Interest expense | | | | | | |
| Interest on deposits | 232 | 2,975 | 304 | 20,188 | 2,339 | 162 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 23 | 479 | 56 | 2,057 | 1,127 | 5 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 7 | 58 | 2 | 9,229 | 115 | 2 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 0 | 2 | 0 | 23 | 7 | 0 |
| Interest on notes and debentures subordinated to deposits | 0 | 19 | 1 | 164 | 13 | 1 |
| *Total interest expense* | 262 | 3,534 | 363 | 31,660 | 3,600 | 170 |
| Net interest income | 176 | 2,598 | 253 | 9,931 | 1,618 | 114 |
| Provision for loan and lease losses | 45 | 407 | 38 | 3,854 | 104 | 8 |
| Provision for allocated transfer risk | 0 | 0 | 0 | 0 | 0 | 0 |
| Noninterest income | | | | | | |
| Service charges on deposit accounts | 22 | 221 | 28 | 456 | 195 | 10 |
| Other noninterest income | 31 | 427 | 45 | 5,547 | 591 | 20 |
| *Total noninterest income* | 53 | 648 | 73 | 6,003 | 786 | 29 |
| Gains and losses on securities not held in trading accounts | 1 | 12 | 1 | 134 | 39 | 0 |
| Noninterest expense | | | | | | |
| Salaries and employee benefits | 65 | 1,019 | 108 | 5,480 | 793 | 43 |
| Expenses of premises and fixed assets (net of rental income) | 21 | 376 | 38 | 1,997 | 280 | 13 |
| Other noninterest expense | 70 | 698 | 71 | 3,939 | 492 | 44 |
| *Total noninterest expense* | 156 | 2,094 | 217 | 11,415 | 1,565 | 100 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 29 | 758 | 72 | 798 | 775 | 35 |
| Applicable income taxes | 7 | 196 | 17 | 1,166 | 189 | 9 |
| Income before extraordinary items and other adjustments | 21 | 562 | 55 | (368) | 586 | 26 |
| Extraordinary items and other adjustments, net of taxes | 0 | 1 | 2 | 0 | (2) | 0 |
| Net income | 21 | 563 | 57 | (368) | 585 | 26 |
| Total cash dividends declared | 19 | 304 | 28 | 1,271 | 279 | 11 |
| Recoveries credited to allowance for possible loan losses | 2 | 44 | 9 | 334 | 25 | 6 |
| Losses charged to allowance for possible loan losses | 28 | 311 | 41 | 2,903 | 100 | 15 |
| Net loan losses | 26 | 267 | 32 | 2,569 | 75 | 9 |

## *Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989 — Continued*

(Dollar amounts in millions)

| | *Ohio* | *Oklahoma* | *Oregon* | *Pennsylvania* | *Puerto Rico* | *Rhode Island* |
|---|---|---|---|---|---|---|
| Number of banks | 135 | 177 | 7 | 163 | 1 | 5 |
| Interest income: | | | | | | |
| Interest and fee income on loans | $ 5,997 | $ 790 | $ 1,172 | $ 7,086 | $ 7 | $ 964 |
| Income from lease financing receivables | 138 | 1 | 23 | 178 | 0 | 145 |
| Interest income on balances due from depository institutions | 185 | 23 | 17 | 543 | 0 | 14 |
| Interest and dividend income on securities | 1,223 | 432 | 219 | 1,662 | 1 | 126 |
| Interest income from assets held in trading accounts | 15 | 3 | 11 | 35 | 0 | 0 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 239 | 90 | 24 | 388 | 1 | 64 |
| *Total interest income* | 7,798 | 1,338 | 1,465 | 9,891 | 10 | 1,314 |
| Interest expense: | | | | | | |
| Interest on deposits | 3,741 | 731 | 621 | 5,042 | 6 | 659 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 738 | 58 | 144 | 1,087 | 1 | 95 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 85 | 17 | 37 | 384 | 0 | 57 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 4 | 0 | 1 | 6 | 0 | 0 |
| Interest on notes and debentures subordinated to deposits | 28 | 1 | 1 | 73 | 0 | 9 |
| *Total interest expense* | 4,596 | 807 | 805 | 6,592 | 7 | 819 |
| Net interest income | 3,203 | 531 | 660 | 3,299 | 3 | 495 |
| Provision for loan and lease losses | 495 | 71 | 101 | 809 | 3 | 114 |
| Provision for allocated transfer risk | 0 | 0 | 0 | 0 | 0 | 0 |
| Noninterest income: | | | | | | |
| Service charges on deposit accounts | 253 | 74 | 92 | 280 | 1 | 20 |
| Other noninterest income | 908 | 160 | 148 | 1,213 | 0 | 225 |
| *Total noninterest income* | 1,161 | 234 | 241 | 1,493 | 1 | 245 |
| Gains and losses on securities not held in trading accounts | 8 | 3 | 2 | 11 | 0 | 5 |
| Noninterest expense: | | | | | | |
| Salaries and employee benefits | 1,092 | 259 | 264 | 1,349 | 2 | 206 |
| Expenses of premises and fixed assets (net of rental income) | 320 | 80 | 78 | 482 | 1 | 37 |
| Other noninterest expense | 1,230 | 268 | 167 | 1,262 | 2 | 150 |
| *Total noninterest expense* | 2,643 | 607 | 509 | 3,093 | 5 | 393 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 1,234 | 89 | 292 | 901 | (4) | 238 |
| Applicable income taxes | 293 | 39 | 88 | 157 | 0 | 77 |
| Income before extraordinary items and other adjustments | 941 | 50 | 204 | 744 | (4) | 160 |
| Extraordinary items and other adjustments, net of taxes | 11 | 6 | 0 | (16) | 0 | 0 |
| Net income | 952 | 56 | 205 | 728 | (4) | 160 |
| Total cash dividends declared | 502 | 28 | 70 | 339 | 0 | 42 |
| Recoveries credited to allowance for possible loan losses | 138 | 29 | 25 | 83 | 2 | 8 |
| Losses charged to allowance for possible loan losses | 583 | 132 | 92 | 1,043 | 4 | 107 |
| Net loan losses | 445 | 103 | 67 | 960 | 2 | 99 |

*Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989 — Continued*
(Dollar amounts in millions)

| | South Carolina | South Dakota | Tennessee | Texas | Utah | Vermont |
|---|---|---|---|---|---|---|
| Number of banks | 29 | 24 | 50 | 687 | 6 | 12 |
| Interest income | | | | | | |
| Interest and fee income on loans | $ 1,375 | $ 2,134 | $ 1,650 | $ 6,589 | $ 483 | $ 206 |
| Income from lease financing receivables | 8 | 0 | 16 | 25 | 12 | 0 |
| Interest income on balances due from depository institutions | 3 | 3 | 59 | 343 | 17 | 1 |
| Interest and dividend income on securities | 288 | 83 | 402 | 2,149 | 96 | 24 |
| Interest income from assets held in trading accounts | 4 | 0 | 22 | 22 | 8 | 0 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 72 | 17 | 89 | 1,067 | 29 | 3 |
| *Total interest income* | 1,752 | 2,238 | 2,238 | 10,195 | 645 | 234 |
| Interest expense | | | | | | |
| Interest on deposits | 742 | 432 | 1,141 | 5,930 | 299 | 127 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 300 | 132 | 211 | 1,045 | 75 | 6 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 36 | 502 | 29 | 356 | 3 | 1 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 1 | 1 | 1 | 15 | 0 | 0 |
| Interest on notes and debentures subordinated to deposits | 4 | 40 | 14 | 16 | 2 | 0 |
| *Total interest expense* | 1,083 | 1,107 | 1,395 | 7,363 | 379 | 134 |
| Net interest income | 669 | 1,131 | 842 | 2,832 | 266 | 100 |
| Provision for loan and lease losses | 75 | 491 | 241 | 1,909 | 51 | 7 |
| Provision for allocated transfer risk | 0 | 0 | 0 | 5 | 0 | 0 |
| Noninterest income | | | | | | |
| Service charges on deposit accounts | 77 | 12 | 110 | 559 | 35 | 6 |
| Other noninterest income | 117 | 1,400 | 260 | 2,412 | 61 | 12 |
| *Total noninterest income* | 195 | 1,413 | 370 | 2,971 | 95 | 18 |
| Gains and losses on securities not held in trading accounts | 3 | (5) | 2 | 71 | (0) | (0) |
| Noninterest expense | | | | | | |
| Salaries and employee benefits | 253 | 180 | 384 | 1,792 | 85 | 38 |
| Expenses of premises and fixed assets (net of rental income) | 92 | 50 | 116 | 672 | 24 | 12 |
| Other noninterest expense | 221 | 1,157 | 362 | 2,056 | 125 | 26 |
| *Total noninterest expense* | 566 | 1,388 | 862 | 4,520 | 235 | 75 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 226 | 660 | 112 | (559) | 75 | 35 |
| Applicable income taxes | 41 | 278 | 18 | (8) | 24 | 10 |
| Income before extraordinary items and other adjustments | 185 | 382 | 95 | (551) | 51 | 25 |
| Extraordinary items and other adjustments, net of taxes | 0 | 26 | 0 | 15 | 5 | 0 |
| Net income | 185 | 408 | 95 | (536) | 56 | 25 |
| Total cash dividends declared | 79 | 362 | 102 | 177 | 17 | 4 |
| Recoveries credited to allowance for possible loan losses | 14 | 124 | 25 | 172 | 13 | 1 |
| Losses charged to allowance for possible loan losses | 70 | 673 | 207 | 1,671 | 52 | 5 |
| Net loan losses | 56 | 549 | 182 | 1,499 | 39 | 4 |

*Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1989 — Continued*
(Dollar amounts in millions)

| | Virginia | Washington | West Virginia | Wisconsin | Wyoming |
|---|---|---|---|---|---|
| Number of banks | 52 | 27 | 84 | 110 | 32 |
| Interest income: | | | | | |
| Interest and fee income on loans | $ 2,062 | $ 2,650 | $ 592 | $ 1,309 | $ 93 |
| Income from lease financing receivables | 12 | 28 | 0 | 16 | 0 |
| Interest income on balances due from depository institutions | 27 | 40 | 12 | 17 | 4 |
| Interest and dividend income on securities | 376 | 183 | 257 | 297 | 73 |
| Interest income from assets held in trading accounts | 10 | 11 | 0 | 7 | 0 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 100 | 31 | 57 | 60 | 12 |
| *Total interest income* | 2,588 | 2,943 | 918 | 1,706 | 182 |
| Interest expense: | | | | | |
| Interest on deposits | 1,239 | 1,294 | 477 | 818 | 97 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 305 | 174 | 48 | 155 | 2 |
| Interest on demand notes issued to the U.S. Treasury and on other borrowed money | 42 | 44 | 2 | 11 | 0 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 1 | 10 | 0 | 1 | 0 |
| Interest on notes and debentures subordinated to deposits | 4 | 20 | 0 | 4 | 0 |
| *Total interest expense* | 1,591 | 1,542 | 528 | 989 | 99 |
| Net interest income | 997 | 1,400 | 391 | 717 | 83 |
| Provision for loan and lease losses | 87 | 165 | 33 | 64 | 5 |
| Provision for allocated transfer risk | 0 | 0 | 0 | 0 | 0 |
| Noninterest income | | | | | |
| Service charges on deposit accounts | 82 | 182 | 20 | 64 | 8 |
| Other noninterest income | 219 | 371 | 43 | 207 | 11 |
| *Total noninterest income* | 301 | 553 | 62 | 271 | 19 |
| Gains and losses on securities not held in trading accounts | 6 | 0 | 0 | 1 | 1 |
| Noninterest expense: | | | | | |
| Salaries and employee benefits | 376 | 599 | 136 | 293 | 32 |
| Expenses of premises and fixed assets (net of rental income) | 125 | 200 | 39 | 85 | 9 |
| Other noninterest expense | 306 | 482 | 107 | 249 | 30 |
| *Total noninterest expense* | 806 | 1,281 | 281 | 626 | 70 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 413 | 508 | 139 | 299 | 28 |
| Applicable income taxes | 98 | 157 | 33 | 83 | 8 |
| Income before extraordinary items and other adjustments | 314 | 351 | 105 | 216 | 21 |
| Extraordinary items and other adjustments, net of taxes | 0 | 20 | 0 | 3 | 1 |
| Net income | 315 | 371 | 105 | 218 | 21 |
| Total cash dividends declared | 117 | 141 | 49 | 125 | 2 |
| Recoveries credited to allowance for possible loan losses | 18 | 60 | 7 | 17 | 8 |
| Losses charged to allowance for possible loan losses | 87 | 188 | 35 | 64 | 16 |
| Net loan losses | 69 | 128 | 28 | 48 | 8 |

Income and expenses of foreign and domestic offices and subsidiaries of national banks, December 31, 1989
(Dollar amounts in millions)

| | 4 163 banks[1] | |
|---|---|---|
| | Consolidated foreign and domestic | Percent distribution |
| Interest income | | |
| Interest and fee income on loans | $147,142 | 76 0 |
| Income from lease financing receivables | 3,146 | 1 6 |
| Interest income on balances due from depository institutions | 8,675 | 4 5 |
| Interest and dividend income on securities | 24,765 | 12.8 |
| Interest income from assets held in trading accounts | 2,426 | 1 3 |
| Interest income from federal funds sold and securities purchased under agreements to resell | 7 440 | 3 8 |
| *Total interest income* | 193,594 | 100 0 |
| Interest expense | | |
| Interest on deposits | 93 370 | 73 7 |
| Expense of federal funds purchased and securities sold under agreements to repurchase | 16,595 | 13 1 |
| Interest on demand notes issued to the U S Treasury and on other borrowed money | 15,605 | 12 3 |
| Interest on mortgage indebtedness and obligations under capitalized leases | 146 | 0.1 |
| Interest on notes and debentures subordinated to deposits | 980 | 0 8 |
| *Total interest expense* | 126,695 | 100 0 |
| Net interest income | 66,899 | |
| Provision for loan and lease losses | 17,672 | |
| Provision for allocated transfer risk | 42 | |
| Noninterest income | | |
| Service charges on deposit accounts | 6,407 | 19.6 |
| Other noninterest income | 26,254 | 80 4 |
| *Total noninterest income* | 32,661 | 100 0 |
| Gains and losses on securities not held in trading accounts | 462 | |
| Noninterest expense | | |
| Salaries and employee benefits | 29,039 | 44.0 |
| Expenses of premises and fixed assets (net of rental income) | 10,121 | 15.3 |
| Other noninterest expense | 26,836 | 40 7 |
| *Total noninterest expense* | 65,995 | 100.0 |
| Income (loss) before income taxes and extraordinary items and other adjustments | 16,312 | |
| Applicable income taxes | 5,856 | |
| Income before extraordinary items and other adjustments | 10,457 | |
| Extraordinary items and other adjustments, net of taxes | 312 | |
| Net income | 10,769 | |
| Total cash dividends declared[2] | 7,955 | |
| Recoveries credited to allowance for possible loan losses | 2,685 | |
| Losses charged to allowance for possible loan losses | 17 550 | |
| Net loan losses | 14,865 | |

[1] Reporting national banks
[2] Banks with assets of less than $100 million report this item only in their December Report of Income.

Deposits of national banks, by states, December 31, 1989
(Dollar amounts in millions)

| | Total demand deposits at domestic offices | All NOW accounts | Money market deposit accounts | Large time deposits | All other deposits at domestic offices | Total deposits at foreign offices | Total consolidated deposits |
|---|---|---|---|---|---|---|---|
| All national banks | $279,363 | $117,928 | $221,684 | $234,526 | $451,183 | $197,965 | $1 502 648 |
| Alabama | 2,341 | 1,127 | 2,406 | 1,823 | 5 009 | 188 | 12 894 |
| Alaska | 812 | 148 | 359 | 504 | 798 | 1 | 2,622 |
| Arizona | 3,208 | 1,498 | 3,028 | 1,511 | 5,879 | 0 | 15,124 |
| Arkansas | 1,608 | 1,259 | 1 139 | 1,208 | 3,669 | 0 | 8 883 |
| California | 38,123 | 13,790 | 29,158 | 24,511 | 40,731 | 28,170 | 174,483 |
| Colorado | 4,202 | 2,124 | 3,323 | 2,414 | 4,694 | 299 | 17,056 |
| Connecticut | 4,163 | 1,408 | 2,836 | 2,398 | 6,225 | 791 | 17 821 |
| Delaware | 284 | 72 | 1,773 | 4,808 | 824 | 15 | 7,776 |
| District of Columbia | 2,890 | 1,350 | 3,470 | 2,780 | 2,612 | 3,077 | 16,179 |
| Florida | 14,994 | 9,156 | 14,722 | 13,312 | 28,699 | 1,401 | 82,283 |
| Georgia | 7,190 | 2,692 | 5,851 | 3,915 | 8,992 | 502 | 29 143 |
| Hawaii | 67 | 31 | 25 | 42 | 75 | 0 | 240 |
| Idaho | 890 | 591 | 874 | 468 | 2 193 | 0 | 5,016 |
| Illinois | 14,566 | 4,783 | 8,207 | 19,433 | 22 303 | 19,944 | 89,235 |
| Indiana | 5,054 | 2,749 | 3,443 | 3,202 | 10,896 | 118 | 25,463 |
| Iowa | 1,845 | 1,098 | 1,070 | 579 | 4,354 | 0 | 8,945 |
| Kansas | 1,720 | 1,228 | 1,587 | 1,440 | 4,105 | 0 | 10,080 |
| Kentucky | 2,446 | 1,464 | 1,217 | 2,027 | 5,458 | 283 | 12,895 |
| Louisiana | 3,979 | 1,573 | 3,265 | 4,300 | 6,215 | 269 | 19,600 |
| Maine | 509 | 322 | 616 | 398 | 1,536 | 0 | 3,382 |
| Maryland | 4,121 | 1,296 | 3,411 | 2,603 | 7,032 | 662 | 19,125 |
| Massachusetts | 7,577 | 2,300 | 9,600 | 8,875 | 8,491 | 10,300 | 47,143 |
| Michigan | 7,745 | 2,266 | 6,124 | 6,427 | 15,172 | 2,258 | 39,992 |
| Minnesota | 5,480 | 2,590 | 3,961 | 5,684 | 8,848 | 500 | 27,064 |
| Mississippi | 1,387 | 845 | 1,053 | 1,215 | 3,323 | 0 | 7,823 |
| Missouri | 5,731 | 2,588 | 3,624 | 2,862 | 8,058 | 103 | 22,965 |
| Montana | 525 | 445 | 588 | 238 | 1,440 | 0 | 3,236 |
| Nebraska | 1,724 | 1,191 | 1,067 | 711 | 4,554 | 0 | 9,247 |
| Nevada | 1,119 | 487 | 982 | 989 | 1,143 | 0 | 4,719 |
| New Hampshire | 560 | 562 | 405 | 531 | 1,661 | 0 | 3,719 |
| New Jersey | 12,354 | 4,724 | 7,925 | 7,452 | 23,110 | 158 | 55,723 |
| New Mexico | 889 | 779 | 778 | 944 | 1,977 | 0 | 5,367 |
| New York | 34,618 | 7,908 | 27,385 | 29,116 | 33,484 | 113,356 | 245,867 |
| North Carolina | 6,972 | 3,348 | 5,483 | 8,620 | 12,032 | 1,489 | 37,944 |
| North Dakota | 374 | 444 | 335 | 241 | 1,380 | 0 | 2,773 |
| Ohio | 11,237 | 5,715 | 8,628 | 9,448 | 27,784 | 2,009 | 64,821 |
| Oklahoma | 2,740 | 1,748 | 1,594 | 1,864 | 5,255 | 44 | 13,246 |
| Oregon | 2,447 | 1,618 | 1,888 | 1,439 | 4,958 | 0 | 12,350 |
| Pennsylvania | 15,370 | 5,282 | 12,744 | 14,551 | 28,238 | 6,992 | 83,176 |
| Puerto Rico | 11 | 4 | 0 | 21 | 33 | 0 | 68 |
| Rhode Island | 1,188 | 487 | 1,337 | 2,779 | 3 383 | 1,101 | 10,275 |
| South Carolina | 2,636 | 2,024 | 2,741 | 1,443 | 4,787 | 0 | 13,631 |
| South Dakota | 588 | 443 | 626 | 590 | 3,737 | 0 | 5,983 |
| Tennessee | 3,630 | 1,748 | 3,330 | 2,210 | 8,113 | 39 | 19 070 |
| Texas | 21,696 | 10,557 | 16,273 | 22 146 | 33,420 | 3,155 | 107,247 |
| Utah | 1,115 | 630 | 861 | 536 | 2,191 | 93 | 5,425 |
| Vermont | 276 | 205 | 260 | 314 | 1,048 | 0 | 2 104 |
| Virginia | 3,791 | 2,201 | 2,203 | 3,761 | 9,269 | 82 | 21,308 |
| Washington | 5,941 | 2,573 | 5,026 | 2,977 | 9,605 | 540 | 26,662 |
| West Virginia | 1,113 | 830 | 717 | 725 | 4,938 | 0 | 8 323 |
| Wisconsin | 3,215 | 1,328 | 2,088 | 1,829 | 6 775 | 26 | 15 262 |
| Wyoming | 300 | 299 | 280 | 312 | 678 | 0 | 1 871 |

*Loans of national banks, by states, December 31, 1989*
(Dollar amounts in millions)

| | Total loans gross | Domestic offices: Loans secured by real estate | Loans to farmers | Commercial and industrial loans | Personal loans to individuals | Other loans | Total loans at foreign offices |
|---|---|---|---|---|---|---|---|
| All national banks | $1,254,438 | $446,370 | $13,941 | $318,163 | $122,926 | $215,381 | $137,657 |
| Alabama | 10,250 | 3,937 | 42 | 3,237 | 699 | 2,336 | 0 |
| Alaska | 1,309 | 446 | 3 | 537 | 41 | 281 | 0 |
| Arizona | 11,815 | 4,035 | 451 | 2,572 | 280 | 4,477 | 0 |
| Arkansas | 5,243 | 2,510 | 187 | 1,204 | 1,054 | 287 | 0 |
| California | 164,426 | 69,125 | 1,978 | 31,599 | 3,644 | 29,799 | 28,281 |
| Colorado | 10,567 | 4,400 | 503 | 2,525 | 2,664 | 473 | 2 |
| Connecticut | 15,287 | 8,310 | 29 | 4,182 | 133 | 2,628 | 6 |
| Delaware | 23,596 | 875 | 1 | 579 | 19,339 | 2,802 | 0 |
| District of Columbia | 12,498 | 5,979 | 0 | 3,438 | 85 | 2,284 | 712 |
| Florida | 65,329 | 34,230 | 155 | 11,541 | 6,476 | 12,804 | 122 |
| Georgia | 24,786 | 9,050 | 66 | 6,839 | 2,455 | 6,210 | 166 |
| Hawaii | 166 | 96 | 0 | 51 | 13 | 7 | 0 |
| Idaho | 4,290 | 1,085 | 398 | 1,133 | 1,246 | 429 | 0 |
| Illinois | 67,579 | 18,024 | 775 | 24,648 | 5,591 | 11,345 | 7,197 |
| Indiana | 16,318 | 7,630 | 263 | 3,717 | 3,683 | 947 | 78 |
| Iowa | 5,770 | 1,936 | 543 | 1,344 | 1,563 | 385 | 0 |
| Kansas | 5,973 | 2,032 | 795 | 1,521 | 1,253 | 372 | 0 |
| Kentucky | 9,898 | 3,355 | 115 | 2,942 | 1,323 | 2,139 | 24 |
| Louisiana | 13,090 | 5,174 | 63 | 3,783 | 1,257 | 2,434 | 380 |
| Maine | 2,962 | 1,763 | 12 | 643 | 451 | 92 | 0 |
| Maryland | 18,550 | 7,840 | 22 | 4,217 | 2,644 | 3,510 | 317 |
| Massachusetts | 45,433 | 15,698 | 14 | 16,507 | 910 | 7,567 | 4,737 |
| Michigan | 29,420 | 10,726 | 94 | 10,298 | 1,789 | 5,391 | 1,122 |
| Minnesota | 23,397 | 5,970 | 465 | 9,398 | 1,676 | 5,639 | 249 |
| Mississippi | 5,473 | 2,286 | 76 | 1,304 | 745 | 1,062 | 0 |
| Missouri | 15,265 | 7,290 | 296 | 4,045 | 1,939 | 1,695 | 0 |
| Montana | 1,823 | 508 | 205 | 522 | 531 | 58 | 0 |
| Nebraska | 6,094 | 1,394 | 1,090 | 1,213 | 1,938 | 458 | 0 |
| Nevada | 11,057 | 1,073 | 14 | 977 | 8,862 | 131 | 0 |
| New Hampshire | 3,337 | 1,631 | 0 | 933 | 691 | 83 | 0 |
| New Jersey | 46,776 | 22,867 | 7 | 14,067 | 3,277 | 6,350 | 208 |
| New Mexico | 3,637 | 1,834 | 102 | 780 | 792 | 128 | 0 |
| New York | 223,055 | 57,189 | 303 | 39,366 | 4,847 | 32,443 | 88,907 |
| North Carolina | 36,553 | 15,425 | 155 | 10,817 | 826 | 8,968 | 362 |
| North Dakota | 1,567 | 540 | 212 | 374 | 373 | 68 | 0 |
| Ohio | 51,955 | 17,341 | 294 | 14,912 | 6,499 | 12,755 | 153 |
| Oklahoma | 7,059 | 2,843 | 612 | 1,897 | 844 | 862 | 0 |
| Oregon | 11,202 | 3,103 | 230 | 4,354 | 34 | 3,481 | 0 |
| Pennsylvania | 70,850 | 20,299 | 119 | 24,303 | 5,274 | 17,946 | 2,909 |
| Puerto Rico | 55 | 19 | 0 | 16 | 20 | 0 | 0 |
| Rhode Island | 9,692 | 3,404 | 2 | 2,963 | 254 | 3,028 | 41 |
| South Carolina | 12,734 | 5,480 | 43 | 3,282 | 2,217 | 1,711 | 0 |
| South Dakota | 3,098 | 564 | 299 | 596 | 10,948 | (9,308) | 0 |
| Tennessee | 14,877 | 6,070 | 47 | 3,689 | 1,356 | 3,714 | 0 |
| Texas | 62,856 | 21,790 | 1,558 | 22,469 | 5,136 | 10,427 | 1,476 |
| Utah | 4,443 | 1,689 | 81 | 1,135 | 123 | 1,416 | 0 |
| Vermont | 1,145 | 1,139 | 20 | 222 | 224 | (460) | 0 |
| Virginia | 18,890 | 8,752 | 111 | 4,084 | 1,481 | 4,459 | 4 |
| Washington | 25,095 | 9,880 | 786 | 6,500 | 601 | 7,138 | 190 |
| West Virginia | 4,914 | 2,636 | 9 | 920 | 1,559 | (210) | 0 |
| Wisconsin | 12,206 | 4,841 | 210 | 3,744 | 1,081 | 2,317 | 14 |
| Wyoming | 777 | 260 | 83 | 224 | 187 | 24 | 0 |

*Outstanding balances, credit cards, and related plans of national banks, December 31, 1989*
(Dollar amounts in thousands)

| | Total number of national banks | Credit cards and other related credit plans | |
|---|---|---|---|
| | | Number of national banks | Outstanding volume |
| All national banks | 4,163 | 2,350 | $89 496 754 |
| Alabama | 50 | 19 | 331 123 |
| Alaska | 4 | 3 | 50 596 |
| Arizona | 14 | 14 | 1 006 783 |
| Arkansas | 81 | 14 | 119 836 |
| California | 163 | 150 | 11,825 040 |
| Colorado | 255 | 225 | 1,283,010 |
| Connecticut | 17 | 11 | 610,069 |
| Delaware | 15 | 15 | 21,171,582 |
| District of Columbia | 24 | 21 | 162,345 |
| Florida | 168 | 85 | 2,831,971 |
| Georgia | 65 | 45 | 2,508,254 |
| Hawaii | 3 | 1 | 3,581 |
| Idaho | 7 | 7 | 197,304 |
| Illinois | 353 | 185 | 355,296 |
| Indiana | 91 | 77 | 922,399 |
| Iowa | 102 | 58 | 503,791 |
| Kansas | 163 | 45 | 296,079 |
| Kentucky | 84 | 37 | 287,524 |
| Louisiana | 50 | 23 | 616,017 |
| Maine | 7 | 7 | 90,552 |
| Maryland | 28 | 21 | 2,638,407 |
| Massachusetts | 39 | 29 | 682,931 |
| Michigan | 75 | 54 | 420,534 |
| Minnesota | 157 | 112 | 913,650 |
| Mississippi | 27 | 13 | 117,310 |
| Missouri | 93 | 56 | 397,771 |
| Montana | 56 | 38 | 57,251 |
| Nebraska | 111 | 50 | 1,094,277 |
| Nevada | 7 | 5 | 8,217,035 |
| New Hampshire | 14 | 10 | 75,812 |
| New Jersey | 56 | 42 | 793,624 |
| New Mexico | 41 | 16 | 191,938 |
| New York | 95 | 64 | 4,252,974 |
| North Carolina | 17 | 15 | 957,265 |
| North Dakota | 30 | 17 | 81,933 |
| Ohio | 135 | 107 | 4,335,354 |
| Oklahoma | 177 | 63 | 49,629 |
| Oregon | 7 | 5 | 901,929 |
| Pennsylvania | 163 | 87 | 792,780 |
| Puerto Rico | 1 | 1 | 7,518 |
| Rhode Island | 5 | 4 | 338 692 |
| South Carolina | 29 | 25 | 958 702 |
| South Dakota | 24 | 11 | 10,086,814 |
| Tennessee | 50 | 27 | 769,082 |
| Texas | 687 | 225 | 889,675 |
| Utah | 6 | 4 | 202,276 |
| Vermont | 12 | 4 | 46,010 |
| Virginia | 52 | 27 | 1,244,720 |
| Washington | 27 | 19 | 2,025,267 |
| West Virginia | 84 | 29 | 94 082 |
| Wisconsin | 110 | 102 | 679 866 |
| Wyoming | 32 | 26 | 8,494 |

*National banks engaged in lease financing, December 31, 1989*
(Dollar amounts in thousands)

| | Total number of national banks | Number of banks engaged in lease financing | Amounts of lease financing at domestic offices |
|---|---|---|---|
| All national banks | 4,163 | 936 | $23,613,459 |
| Alabama | 50 | 5 | 72,953 |
| Alaska | 4 | 1 | 15,601 |
| Arizona | 14 | 4 | 342,164 |
| Arkansas | 81 | 22 | 16,020 |
| California | 163 | 48 | 4,002,905 |
| Colorado | 255 | 71 | 154,621 |
| Connecticut | 17 | 3 | 687 |
| Delaware | 15 | 2 | 83,486 |
| District of Columbia | 24 | 4 | 72,840 |
| Florida | 168 | 26 | 402,122 |
| Georgia | 65 | 11 | 470,176 |
| Hawaii | 3 | 1 | 2,741 |
| Idaho | 7 | 3 | 99,840 |
| Illinois | 353 | 81 | 78,533 |
| Indiana | 91 | 44 | 394,730 |
| Iowa | 102 | 18 | 9,320 |
| Kansas | 163 | 34 | 37,888 |
| Kentucky | 84 | 22 | 193,616 |
| Louisiana | 50 | 11 | 19,899 |
| Maine | 7 | 2 | 3,674 |
| Maryland | 28 | 6 | 533,098 |
| Massachusetts | 39 | 12 | 3,076,235 |
| Michigan | 75 | 20 | 366,281 |
| Minnesota | 157 | 64 | 522,894 |
| Mississippi | 27 | 3 | 3,694 |
| Missouri | 93 | 23 | 173,171 |
| Montana | 56 | 7 | 1,067 |
| Nebraska | 111 | 27 | 63,048 |
| Nevada | 7 | 3 | 4,066 |
| New Hampshire | 14 | 2 | 13,781 |
| New Jersey | 56 | 15 | 438,957 |
| New Mexico | 41 | 13 | 20,615 |
| New York | 95 | 20 | 3,887,823 |
| North Carolina | 17 | 6 | 1,102,721 |
| North Dakota | 30 | 12 | 10,845 |
| Ohio | 135 | 61 | 1,507,477 |
| Oklahoma | 177 | 40 | 10,764 |
| Oregon | 7 | 3 | 353,596 |
| Pennsylvania | 163 | 33 | 1,936,334 |
| Puerto Rico | 1 | 0 | 0 |
| Rhode Island | 5 | 2 | 1,749,417 |
| South Carolina | 29 | 7 | 71,172 |
| South Dakota | 24 | 9 | 3,712 |
| Tennessee | 50 | 15 | 173,129 |
| Texas | 687 | 52 | 380,055 |
| Utah | 6 | 5 | 151,321 |
| Vermont | 12 | 1 | 1,365 |
| Virginia | 52 | 6 | 110,252 |
| Washington | 27 | 8 | 276,376 |
| West Virginia | 84 | 7 | 2,778 |
| Wisconsin | 110 | 38 | 193,128 |
| Wyoming | 32 | 3 | 471 |

*Consolidated foreign and domestic loans and leases past due at national banks, by states, December 31, 1989*
(Dollar amounts in millions)

| | Number of banks | Type of loan | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | All real estate | Commercial and industrial[1] | Personal[2] | Leases | Other loans[1] | Total loans | To non-U.S. addresses[3] |
| All national banks | 4,163 | $12,406.3 | $7,022.1 | $8,707.9 | $397.400 | $1,144.2 | $29,677.9 | $795.95 |
| Alabama | 50 | 62.3 | 50.1 | 80.1 | 0.016 | 4.1 | 196.7 | 0.00 |
| Alaska | 4 | 9.0 | 8.3 | 1.3 | 0.009 | 1.5 | 20.1 | 0.00 |
| Arizona | 14 | 205.1 | 93.2 | 75.4 | 3.395 | 39.1 | 416.1 | 9.46 |
| Arkansas | 81 | 68.9 | 39.5 | 27.0 | 0.093 | 1.1 | 136.6 | 0.00 |
| California | 163 | 1,584.7 | 1,056.3 | 617.1 | 25.489 | 282.4 | 3,566.0 | 129.79 |
| Colorado | 255 | 98.5 | 117.9 | 91.5 | 5.066 | 4.6 | 317.6 | 0.00 |
| Connecticut | 17 | 343.2 | 148.8 | 103.9 | 0.000 | 24.0 | 619.9 | 0.02 |
| Delaware | 15 | 18.4 | 3.9 | 839.2 | 1.114 | 0.0 | 862.7 | 0.00 |
| District of Columbia | 24 | 210.3 | 103.9 | 34.7 | 0.087 | 22.5 | 371.5 | 2.32 |
| Florida | 168 | 824.3 | 272.7 | 364.2 | 6.877 | 37.7 | 1,505.9 | 3.34 |
| Georgia | 65 | 164.9 | 162.9 | 236.0 | 20.823 | 11.5 | 596.0 | 3.46 |
| Hawaii | 3 | 0.2 | 0.6 | 0.1 | 0.002 | 0.0 | 0.9 | 0.00 |
| Idaho | 7 | 14.3 | 13.7 | 22.1 | 0.040 | 2.3 | 52.5 | 0.00 |
| Illinois | 353 | 287.5 | 245.7 | 148.4 | 3.479 | 13.2 | 698.3 | 4.84 |
| Indiana | 91 | 139.4 | 80.3 | 172.2 | 4.239 | 8.2 | 404.4 | 0.00 |
| Iowa | 102 | 28.0 | 28.4 | 56.2 | 0.085 | 0.4 | 113.1 | 0.00 |
| Kansas | 163 | 33.5 | 28.7 | 24.5 | 0.557 | 0.0 | 87.2 | 0.00 |
| Kentucky | 84 | 86.6 | 50.4 | 63.8 | 1.137 | 15.2 | 217.2 | 0.00 |
| Louisiana | 50 | 157.2 | 86.7 | 84.2 | 0.517 | 18.6 | 347.1 | 0.00 |
| Maine | 7 | 65.4 | 25.9 | 19.8 | 0.074 | 0.5 | 111.7 | 0.00 |
| Maryland | 28 | 112.7 | 56.7 | 209.9 | 14.924 | 19.3 | 413.6 | 1.46 |
| Massachusetts | 39 | 519.2 | 221.0 | 124.3 | 49.036 | 14.2 | 927.6 | 9.20 |
| Michigan | 75 | 176.1 | 116.4 | 105.2 | 5.406 | 31.2 | 434.4 | 3.90 |
| Minnesota | 157 | 103.0 | 279.8 | 101.6 | 1.810 | 34.1 | 520.3 | 0.00 |
| Mississippi | 27 | 57.9 | 22.7 | 42.8 | 0.000 | 1.5 | 124.9 | 0.00 |
| Missouri | 93 | 120.9 | 85.4 | 67.3 | 0.881 | 4.9 | 279.3 | 0.00 |
| Montana | 56 | 12.5 | 16.8 | 9.1 | 0.000 | 0.8 | 39.1 | 0.00 |
| Nebraska | 111 | 22.8 | 26.2 | 53.4 | 0.266 | 2.8 | 105.4 | 0.00 |
| Nevada | 7 | 26.8 | 24.5 | 430.8 | 0.031 | 1.5 | 483.6 | 0.00 |
| New Hampshire | 14 | 102.7 | 38.6 | 35.5 | 0.023 | 0.0 | 176.8 | 0.00 |
| New Jersey | 56 | 868.5 | 418.1 | 234.6 | 30.685 | 40.2 | 1,592.2 | 0.10 |
| New Mexico | 41 | 78.4 | 38.8 | 23.1 | 0.087 | 4.2 | 144.5 | 0.00 |
| New York | 95 | 2,759.8 | 656.7 | 1,071.4 | 87.385 | 172.5 | 4,747.8 | 594.28 |
| North Carolina | 17 | 200.4 | 76.6 | 121.2 | 6.028 | 12.3 | 416.6 | 2.64 |
| North Dakota | 30 | 11.8 | 15.6 | 8.6 | 0.001 | 0.9 | 36.9 | 0.00 |
| Ohio | 135 | 289.6 | 236.9 | 546.1 | 19.658 | 30.2 | 1,122.6 | 2.50 |
| Oklahoma | 177 | 60.6 | 46.3 | 29.0 | 0.000 | 1.8 | 137.7 | 0.00 |
| Oregon | 7 | 60.2 | 67.2 | 49.8 | 1.669 | 9.9 | 188.8 | 0.00 |
| Pennsylvania | 163 | 417.3 | 362.9 | 293.4 | 37.433 | 96.1 | 1,207.1 | 12.69 |
| Puerto Rico | 1 | 0.2 | 11.4 | 1.3 | 0.000 | 0.0 | 13.0 | 0.00 |
| Rhode Island | 5 | 207.0 | 72.1 | 39.2 | 44.014 | 1.8 | 364.2 | 0.00 |
| South Carolina | 29 | 82.4 | 34.6 | 71.4 | 3.897 | 3.1 | 195.4 | 0.00 |
| South Dakota | 24 | 5.2 | 427.3 | 1,247.6 | 0.020 | 2.8 | 1,683.0 | 0.00 |
| Tennessee | 50 | 95.3 | 72.9 | 123.2 | 2.226 | 13.0 | 306.7 | 0.00 |
| Texas | 687 | 785.0 | 646.2 | 235.3 | 9.349 | 89.4 | 1,765.2 | 13.99 |
| Utah | 6 | 45.8 | 17.7 | 28.0 | 0.952 | 1.3 | 93.7 | 0.00 |
| Vermont | 12 | 23.0 | 19.7 | 7.5 | 0.301 | 0.5 | 50.9 | 0.00 |
| Virginia | 52 | 339.7 | 78.7 | 110.6 | 1.068 | 30.8 | 561.0 | 0.00 |
| Washington | 27 | 248.5 | 79.4 | 114.1 | 2.778 | 32.8 | 477.4 | 0.00 |
| West Virginia | 84 | 80.0 | 37.9 | 63.2 | 0.000 | 0.0 | 181.2 | 1.75 |
| Wisconsin | 110 | 85.3 | 86.9 | 42.2 | 4.373 | 3.1 | 221.8 | 0.21 |
| Wyoming | 32 | 6.1 | 12.3 | 5.6 | 0.000 | 0.0 | 24.0 | 0.00 |

[1]For banks with assets of less than $300 million, this category captures commercial (time and demand) and all other loans.
[2]For banks with assets of less than $300 million, this category captures installment loans and credit cards and related plans.
[3]Does not include banks with assets of less than $300 million.

## Percent of total loans past due, by asset size of national banks

| | Less than $300M | $300M to $1B | $1B to $10B | Over $10B | All national banks |
|---|---|---|---|---|---|
| Real estate | | | | | |
| March 1989 | 1.19 | 1.00 | 0.95 | 1.15 | 1.08 |
| June 1989 | 1.07 | 0.88 | 0.77 | 0.78 | 0.82 |
| September 1989 | 1.09 | 0.93 | 0.94 | 0.87 | 0.92 |
| December 1989 | 1.15 | 0.96 | 0.92 | 0.96 | 0.97 |
| Commercial and industrial[1] | | | | | |
| March 1989 | 1.21 | 0.73 | 0.63 | 0.59 | 0.69 |
| June 1989 | 1.07 | 0.67 | 0.49 | 0.53 | 0.59 |
| September 1989 | 1.09 | 0.70 | 0.52 | 0.48 | 0.58 |
| December 1989 | 0.97 | 0.61 | 0.52 | 0.46 | 0.55 |
| Personal[2] | | | | | |
| March 1989 | 0.54 | 0.64 | 0.64 | 0.57 | 0.59 |
| June 1989 | 0.51 | 0.68 | 0.63 | 0.57 | 0.59 |
| September 1989 | 0.56 | 0.77 | 0.78 | 0.54 | 0.64 |
| December 1989 | 0.60 | 0.84 | 0.84 | 0.56 | 0.68 |
| Leases | | | | | |
| March 1989 | 0.01 | 0.01 | 0.03 | 0.02 | 0.02 |
| June 1989 | 0.01 | 0.01 | 0.03 | 0.03 | 0.02 |
| September 1989 | 0.01 | 0.01 | 0.03 | 0.03 | 0.03 |
| December 1989 | 0.01 | 0.01 | 0.05 | 0.03 | 0.03 |
| Other loans[3] | | | | | |
| March 1989 | —[4] | 0.07 | 0.13 | 0.23 | 0.16 |
| June 1989 | — | 0.06 | 0.11 | 0.27 | 0.17 |
| September 1989 | — | 0.07 | 0.11 | 0.16 | 0.12 |
| December 1989 | — | 0.06 | 0.09 | 0.11 | 0.09 |
| Total loans | | | | | |
| March 1989 | 2.96 | 2.46 | 2.38 | 2.55 | 2.54 |
| June 1989 | 2.66 | 2.29 | 2.03 | 2.17 | 2.19 |
| September 1989 | 2.75 | 2.49 | 2.38 | 2.08 | 2.29 |
| December 1989 | 2.72 | 2.48 | 2.42 | 2.11 | 2.32 |

NOTES

*Past due loans*—These items are (1) single payment notes 30 days or more past maturity, (2) single payment notes with interest due at specified intervals and demand notes on which interest in due and unpaid for 30 days or more (3) amortizing real estate loans and closed-end monthly installment loans and lease financing receivables in arrears two or more monthly payments, or, if scheduled other than monthly, when one scheduled payment is due and unpaid for 30 days or more, (4) open-end credit accounts on which the customer has not made the minimum monthly payment for two or more billing cycles, and (5) unplanned overdrafts outstanding 30 days or more after origination

[1]For banks with assets of less than $300 million, this category captures commercial (time and demand) and all other loans

[2]For banks with assets of less than $300 million, this category captures installment loans and credit cards and related plans

[3]Data not available for banks with assets of less than $300 million

[4]Data not available

# Office of the Comptroller of the Currency — Financial Statements December 31, 1989

## Balance Sheets

| Assets | December 31 1989 | December 31 1988 |
|---|---|---|
| Current assets: | | |
| Cash | $ 599,611 | $ 1,123,166 |
| Receivables: | | |
| Travel advances | 882,776 | 794,967 |
| Accounts receivable | 2,559,064 | 2,194,443 |
| Accrued interest | 2,288,078 | 970,771 |
| Total receivables | 5,729,918 | 3,960,181 |
| Investment securities | 82,509,871 | 61,301,145 |
| Prepaid expenses and other assets | 1,843,439 | 1,754,106 |
| Total current assets | 90,682,839 | 68,138,598 |
| Investment securities, long term | — | 11,699,213 |
| Other non-current assets | 50,000 | 100,000 |
| Fixed assets and leasehold improvements: | | |
| Furniture, equipment and software | 14,070,320 | 19,266,113 |
| Leasehold improvements | 18,591,379 | 16,759,233 |
| | 32,661,699 | 36,025,346 |
| Less accumulated depreciation and amortization | 16,212,674 | 17,545,325 |
| Net fixed assets and leasehold improvements | 16,449,025 | 18,480,021 |
| Total assets | $107,181,864 | $ 98,417,832 |
| **Liabilities and Comptroller's Equity** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 9,256,415 | $ 8,433,999 |
| Accrued travel and salaries | 7,075,200 | 6,773,771 |
| Total current liabilities | 16,331,615 | 15,207,770 |
| Long-term liabilities: | | |
| Accumulated annual leave | 11,250,703 | 10,362,356 |
| Total liabilities | 27,582,318 | 25,570,126 |
| Comptroller's equity: | | |
| Unrestricted | 79,599,546 | 72,847,706 |
| Total liabilities and equity | $107,181,864 | $ 98,417,832 |

See accompanying notes to financial statements

## Statements of Revenue, Expenses and Changes in Comptroller's Equity

| | Years ended December 31 | |
|---|---|---|
| | 1989 | 1988 |
| Revenue | | |
| Semiannual assessments | $226,806,532 | $192,437,031 |
| Examinations and investigations | 15,567,163 | 13,227,640 |
| Investment income | 10,365,358 | 8,019,425 |
| Publication sales | 1,097,869 | 1,234,199 |
| Other | 188,341 | 141,690 |
| Total revenue | 254,025,263 | 215,059,985 |
| Expenses | | |
| Salaries and benefits | 168,036,744 | 154,197,937 |
| Office space costs | 23,694,077 | 17,986,948 |
| Travel | 19,575,370 | 16,697,984 |
| Automated services | 13,941,852 | 8,664,922 |
| Communications | 5,252,538 | 4,852,385 |
| Relocation | 3,636,369 | 2,533,734 |
| Office equipment and furniture | 3,543,959 | 4,039,598 |
| Outside services | 2,940,150 | 2,316,007 |
| Office supplies, materials and services | 2,147,029 | 2,191,570 |
| Training | 1,876,610 | 1,692,083 |
| Printing and graphics | 1,854,461 | 1,364,474 |
| Conference | 774,264 | 553,342 |
| Total expenses | 247,273,423 | 217,090,984 |
| Excess (deficiency) of revenue over expenses | 6,751,840 | (2,030,999) |
| Comptroller's equity at beginning of year | 72,847,706 | 74,878,705 |
| Comptroller's equity at end of year | $ 79,599,546 | $ 72,847,706 |

See accompanying notes to financial statements.

# Office of the Comptroller of the Currency — Financial Statements December 31, 1989

## Statements of Cash Flows

| | Years ended December 31 | |
|---|---|---|
| | 1989 | 1988 |
| Cash flows from operating activities: | | |
| Excess (Deficiency) of revenue over expenses | $6,751,840 | $ (2,030,999) |
| Adjustments to reconcile net income to net cash (used) provided by operating activities: | | |
| Depreciation, amortization and losses (gains) on disposals | 4,607,479 | 2,930,547 |
| Increase in accounts receivable, prepaid expenses and other assets | (1,859,070) | (1,308,541) |
| Decrease in non-current assets | 50,000 | 50,000 |
| Increase in accrued annual leave | 888,347 | 858,408 |
| Increase (decrease) in accounts payable, accrued payroll, travel, and other liabilities | 1,123,845 | (6,269,656) |
| Net cash provided (used) by operating activities | 11,562,441 | (5,770,241) |
| Cash flows from investing activities: | | |
| Proceeds from sale of fixed assets | 9,875 | 15,050 |
| Purchases of fixed assets | (2,370,692) | (2,790,298) |
| Proceeds from the sales of investment securities | 297,156,038 | 221,305,346 |
| Purchases of investment securities | (306,881,217) | (215,336,434) |
| Net cash (used) provided in investing activities | (12,085,996) | 3,193,664 |
| Net (decrease) in cash | (523,555) | (2,576,577) |
| Cash balance, beginning of year | 1,123,166 | 3,699,743 |
| Cash balance, end of year | $ 599,611 | $ 1,123,166 |

See accompanying notes to financial statements.

## Notes to Financial Statements, December 31, 1989 and 1988

### Note 1 — Organization

The Office of the Comptroller of the Currency (Comptroller's Office) was created by an Act of Congress for the purpose of establishing and regulating a national banking system. The National Currency Act of 1863, rewritten and reenacted as The National Banking Act of 1864, created the Comptroller's Office and provided for its supervisory functions and the chartering of banks.

No funds derived from taxes or federal appropriations are allocated to or used by the Comptroller's Office in any of its operations. The revenue of the Comptroller's Office is derived principally from assessments and fees paid by the national banks and income on investments in U.S. Government obligations. The Comptroller's Office is exempt from federal and state income taxes.

### Note 2 — Significant Accounting Policies

The accounting policies of the Comptroller's Office conform to generally accepted accounting principles, accordingly, the financial statements are presented on the accrual basis of accounting.

Investment securities are U.S. Treasury obligations stated at amortized cost which approximates market value. Premiums and discounts on investment securities are amortized on a straight-line basis to maturity. For the purpose of the statement of cash flows, the Comptroller's Office does not consider investment securities as cash equivalents.

Furniture and equipment are capitalized at cost less accumulated depreciation calculated on a straight-line basis over the estimated useful lives of the assets, which range from 3 to 10 years. Leasehold improvements are capitalized at cost less accumulated amortization computed over the terms of the related leases (including renewal options) or the estimated useful lives, whichever is shorter. Expenditures for maintenance and repairs are charged to earnings as incurred.

### Note 3 — Commitments

The Comptroller's Office occupies office space in Washington, D.C. under a lease agreement which provided for an initial five-year term with five consecutive five-year renewal options. During 1984, the second of these renewal options, expiring in 1989, was exercised. In December 1988, the Comptroller's Office decided to not exercise the third renewal option and to relocate its Washington, D.C. office space in 1991. As a result of this decision, the Comptroller's Office has negotiated a lease that extends until the occupancy of the new office space. A lease has been negotiated for the new office space through the year 2006. The capitalized improvements for the current space are being amortized over the anticipated remaining life of the negotiated lease, resulting in additional annual expenses of $3,300,000 through 1991. The district and field offices lease space under agreements which expire at various dates through 2006. Minimum rental commitments at December 31, 1989 are as follows:

| | |
|---|---|
| 1990 | $ 12,722,000 |
| 1991 | 15,957,000 |
| 1992 | 20,142,000 |
| 1993 | 20,081,000 |
| 1994 | 19,310,000 |
| 1995 and after | 170,295,000 |
| | $258,507,000 |

Certain of these leases provide that annual rentals may be adjusted to provide for increases in taxes and other related expenses. Total rental expense under leases was $19,150,000 and $14,915,000 for the years ended December 31, 1989 and 1988, respectively.

### Note 4 — Retirement Plans

The Comptroller's Office contributes to the Civil Service retirement plan and the Federal Employees' Retirement System administered by OPM for the benefit of all its eligible employees. Contributions aggregated $11,973,000 and $11,105,000 in 1989 and 1988, respectively. The plans are participatory, with 7 percent of salary being contributed by each party for the Civil Service retirement plan. Under the Federal Employees' Retirement System, the Comptroller's Office contributed 12.86 percent of salary and the participating employees contributed .94 percent.

Additionally, the Comptroller's Office contributed up to 5 percent of basic pay for participants in the Thrift

Savings Plan under the Federal Employees Retirement System. The Comptroller's Office also contributes Social Security and Medicare benefits for all eligible employees.

## Note 5 — Contingencies

Various banks in the District of Columbia have deposited securities with the Comptroller's Office as collateral for those banks entering into and administering trust activities. These securities, having a par or stated value of $17,060,000, are not assets of the Comptroller's Office and accordingly are not included in the accompanying financial statements.

The Comptroller's Office is a defendant, together with other bank supervisory agencies and other persons, in litigation related to the closing of certain national banks. In the opinion of the Comptroller's legal staff, the Comptroller's Office will be able to defend successfully against these complaints and no material liability is expected to result therefrom.

[illegible]
1801 K Street N.W.
Washington DC 20006
Telephone [illegible]

# Price Waterhouse

## Report of Independent Accountants

March 9, 1990

Comptroller of the Currency

In our opinion, the accompanying balance sheets and the related statements of revenue, expenses and changes in comptroller's equity and of cash flows present fairly, in all material respects, the financial position of the Office of the Comptroller of the Currency (Comptroller's Office) at December 31, 1989 and 1988, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Comptroller's Office management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards and the financial audit standards in *Government Auditing Standards* issued by the Comptroller General. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse

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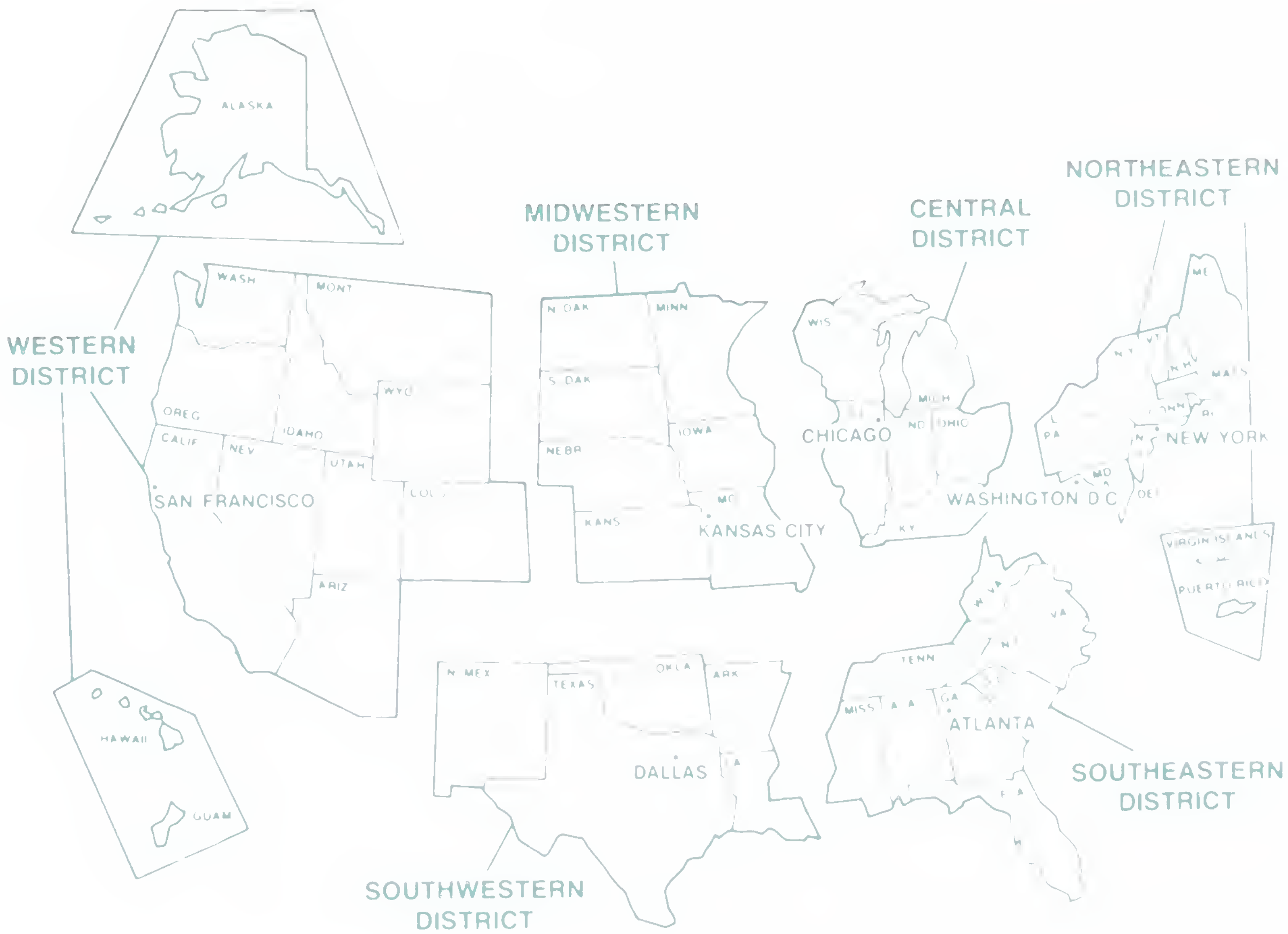


## Northeastern District

New York District Office
11[illegible]4 Avenue of the Americas
Suite 3900
New York, NY 10036

Commercial 212-819-986[illegible]

## Central District

Chicago District Office
One Financial Plaza
Suite 2700
440 South LaSalle Street
Chicago, IL 60605

FTS [illegible]
Commercial [illegible]

## Southwestern District

Dallas District Office
[illegible] Plaza
[illegible] North Akard
Dallas, TX 75201-3394

Commercial [illegible]

## Southeastern District

Atlanta District Office
Marquis One Tower
Suite 600
245 Peachtree Center Ave., N.E.
Atlanta, GA 3030[illegible]

Commercial 404-[illegible]

## Midwestern District

Kansas City District Office
2345 Grand Avenue
Suite [illegible]
Kansas City, MO [illegible]

Commercial [illegible]

## Western District

San Francisco District Office
[illegible]
[illegible]
San Francisco, CA [illegible]

FTS [illegible]
Commercial [illegible]

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